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9

10 UNITED STATES DISTRICT COURT

11 NORTHERN DISTRICT OF CALIFORNIA

12 CHRIS CRIMI, on Behalf of Himself and All
Others Similarly Situated,

13 Plaintiff,

14 vs.

15 EDWARD W. BARNHOLT, H. RAYMOND
16 BINGHAM, ROBERT T. BOND, RICHARD J.
ELKUS, JR., STEPHEN P. KAUFMAN,
17 KENNETH LEVY, MICHAEL E. MARKS,
DEAN O. MORTON, KENNETH L.
18 SCHROEDER, JON D. TOMPKINS,
RICHARD P. WALLACE, KLA-TENCOR
19 CORPORATION, and DOES 1 through 25,

20 Defendants.
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Case No. CV-08-2249 CRB

**REQUEST FOR JUDICIAL
NOTICE IN SUPPORT OF
DEFENDANT KLA-TENCOR'S
MOTION TO DISMISS;
DECLARATION OF MATTHEW S.
WEILER**

DATE: June 13, 2008

TIME: 10 A.M.

DEP'T: Courtroom 8

Hon. Charles R. Breyer

REQUEST FOR JUDICIAL NOTICE

In accordance with Federal Rule of Evidence 201, defendant KLA-Tencor Corporation (“KLA”) respectfully request that this Court take judicial notice of each of the following exhibits accompanying this Request for Judicial Notice.

Federal Rule of Evidence 201 allows a court to take judicial notice of facts that are “not subject to reasonable dispute in that [they are] either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned.” Fed. R. Evid. 201(b).

This Court can take judicial notice of pleadings filed in other cases. *Egan v. Teets*, 251 F.2d 571 (9th Cir. 1957) (District Court can take judicial notice of pleadings filed involving same party); *Mir v. Little Co. of Mary Hosp.*, 844 F.2d 646, 649 (9th Cir.1988) (judicial notice was taken of complaints in related actions). Here, the complaints sought to be judicially noticed involve many of the same defendants, and substantially similar factual allegations. Accordingly, the following complaints are the proper subject of judicial notice: Benjamin Langford v. Edward W. Barnholt, et al. (Del. Ch.); In re KLA-Tencor Corporation Shareholder Derivative Litigation, No. C-06-03445-JW (N.D. Cal.); Jeffrey A. Rabin v. Edward W. Barnholt, et al. No. 106CV064841 (Cal. Super.); In re KLA-Tencor Corporation Securities Litigation, No. 06-CV-04065 MJJ (N.D. Cal.).

Public filings, such as filings made with the U.S. Securities and Exchange Commission (the “SEC”), are the proper subject of judicial notice. *See, e.g., In re Calpine Corp. Sec. Litig.*, 288 F. Supp. 2d 1054, 1076 (N.D. Cal. 2003) (court may take judicial notice of documents filed with the SEC); *Yuen v. U.S. Stock Transfer Co.*, 966 F. Supp. 944, 945 n.1 (C.D. Cal. 1997) (court may take judicial notice of the contents of SEC filings). Accordingly, the contents of Forms 10-K and Forms 14A Definitive Proxy Statements, cited in Plaintiff’s FAC, are thereby incorporated by reference, and can be considered for purposes of this motion to dismiss. *See In re Stac Elecs. Sec. Litig.*, 89 F.3d 1399, 1405 n.4 (9th Cir. 1996) (“[C]onsideration [of other portions of a document referenced in a complaint] is appropriate in the context of a motion to dismiss, and does not cover the motion into one for summary judgment”); *In re Computer Sciences Corp.*

Derivative Litig., 244 F.R.D. 580, 587 n.8 (C.D. Cal. 2007) (“The Court therefore takes judicial notice of [Forms 14-A Definitive Proxy Statements] under Federal Rule of Evidence 201, as they are: 1) public records filed with the SEC; 2) documents whose contents are alleged in Plaintiffs’ Complaint; or 3) documents that are “capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned.”). Thus, the Court can take judicial notice of the 1998 and 2004 Definitive Proxy Statements attached hereto.

DATED: May 7, 2008

MORGAN LEWIS & BOCKIUS, LLP

By: /s/
Matthew S. Weiler

Attorneys for Defendant KLA-Tencor Corporation

DECLARATION OF MATTHEW S. WEILER

I, Matthew S. Weiler, declare as follows:

1. I am an attorney at law, licensed to practice before the courts of the State of California and before this Court. I am an associate of the law firm Morgan, Lewis & Bockius LLP, attorneys of record for defendant KLA-Tencor Corporation. I am making this declaration in support of Defendant KLA-Tencor Corporation's Motion to Dismiss. I know the following to be true of my own personal knowledge and if called as a witness could and would testify competently thereto.

2. On or about July 21, 2006, a complaint entitled Benjamin Langford v. Edward W. Barnholt, et al. was filed in the Delaware Court of Chancery, New Castle County. A true and correct copy of an amended complaint in this action, filed on or about March 5, 2007, is attached hereto as Exhibit 1.

3. On or about June 2, 2006, a verified shareholder derivative complaint entitled Jeffrey A. Rabin v. Edward W. Barnholt, et al., No. 106CV064841, was filed in the Superior Court of California for the County of Santa Clara. A true and correct copy of this complaint is attached hereto as Exhibit 2.

4. On or about May 22, 2006, the first of four shareholder derivative actions was filed in the United States District Court for the Northern District of California. These actions were later consolidated under the caption In re KLA-Tencor Corporation Shareholder Derivative Litigation, No. C-06-03445-JW. A true and correct copy of the operative consolidated complaint, filed on February 20, 2007, is attached hereto as Exhibit 3.

EXHIBIT 1

IN THE COURT OF CHANCERY FOR THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

BENJAMIN LANGFORD.

Plaintiff

- against -

Case Number: 2295-N

EDWARD W. BARNHOLT, H. RAYMOND BINGHAM, ROBERT J. BOEHLKE, ROBERT T. BOND, GARY E. DICKERSON, RICHARD J. ELKUS, JR., DENNIS J. FORTINO, STEPHEN P. KAUFMAN, JOHN H. KISPERS, KENNETH LEVY, MICHAEL E. MARKS, ARTHUR P. SCHNITZER, KENNETH L. SCHROEDER, JON D. TOMPKINS, LIDA URBANEK, and KLA-TENCOR CORPORATION

Defendants.

AMENDED COMPLAINT¹

Plaintiff brings this action as a derivative action on behalf of KLA-TENCOR CORPORATION ("KLA" or the "Company") and as a class action on behalf of the shareholders of KLA because their stockholding interests were diluted and affected as a result of the issuance of void stock options and their subsequent exercise. Plaintiff alleges, upon information and belief, the following, except upon personal knowledge as to his ownership of KLA stock.

I. PRELIMINARY ALLEGATIONS

1 Pursuant to Chancery Court Rule 15(aa) matter added to the original complaint is shown in underline and deleted matter is shown in cross-out.

1. Plaintiff is a shareholder of KLA as a result of its merger with Tencor Instruments in 1997. He continues to own these shares since its acquisition.

2. KLA is a corporation organized and existing under the laws of the State of Delaware. It is a supplier of process control and yield management solutions for the semiconductor and related microelectronics industries.

3. Defendant Kenneth L. Schroeder ("Schroeder") has served as a director of KLA and as Chief Executive Officer of the Company since July 1999. Schroeder served as President of the Company from November 1991 to July 2002 and again from May 2004 to July 2005.

4. Defendant Kenneth Levy ("Levy"), a founder of KLA, has served as a director of KLA since 1975 and as Chairman of the Board of Directors ("Board") since July 1999. Levy served as Chief Executive Officer of the Company from July 1998 to June 1999.

5. Defendant Jon D. Tompkins ("Tompkins") has served as a director of KLA since April 1997. Tompkins served as Chairman of the Board from July 1998 to June 1999 and as Chief Executive Officer of the Company from May 1997 to July 1998.

6. Defendant Robert J. Boehlke ("Boehlke") served as Executive Vice President and Chief Financial Officer of the Company from 1992 to 2000.

7. Defendant Stephen P. Kaufman ("Kaufman") has been a director since November 2002.

8. Defendant Michael E. Marks ("Marks") has been a director since November 2003.

9. Defendant Gary E. Dickerson ("Dickerson") served as Executive Vice President of the Company from 1995 to 1999 and as President and Chief Operating Officer of the Company from 1999 to 2004.

10. Defendant Arthur P. Schnitzer ("Schnitzer") served as Executive Vice President of the Company at all times relevant hereto. Schnitzer is a citizen of the State of California.

11. Defendant John H. Kispert ("Kispert") has served as Executive Vice President and Chief Financial Officer of the Company since 2000.

12. Defendant Dennis J. Fortino ("Fortino") has served as Executive Vice President of the Company since 1999.

13. Collectively, defendants Schroeder, Levy, Tompkins, Boehlke, Dickerson, Schnitzer, Kispert, and Fortino are referred to herein as the "Officer Defendants".

14. Defendant Lida Urbanek ("Urbanek") has served as a director of KLA and as a member of the Compensation Committee of the Board (the "Compensation Committee") since 1997.

15. Defendant Edward W. Barnholt ("Barnholt") has served as a director of KLA since 1995 and as a member of the Compensation Committee since 2000.

16. Defendant Robert T. Bond ("Bond") has served as a director of KLA and as a member of the Compensation Committee since 2000. Bond has also served as a member of the Audit Committee of the Board (the "Audit Committee") since 2002.

17. Collectively, defendants Urbanek, Barnholt, and Bond are referred to herein as the "Compensation Committee Defendants".

18. Defendant Richard J. Elkus, Jr. ("Elkus") has served as a director of KLA since 1997 and as a member of the Audit Committee since 1999.

19. Defendant H. Raymond Bingham ("Bingham") has served as a director of KLA since 1999 and as a member of the Audit Committee since 2000.

20. Collectively, defendants Bond, Elkus, and Bingham are referred to herein as the "Audit Committee Defendants".

21. KLA had adopted stock option plans which were shareholder approved. Under such plans, the exercise price of the stock options granted cannot be less than the closing price of KLA stock on the date of grant.

22. The Compensation Committee, determined, among other things, the stock option awards, for executive officers of KLA and administered the Company stock option plans.

23. From 1997 to 2001 the Compensation Committee granted stock options to various defendants (adjusted for KLA's two-for-one stock split effective January 19, 2000) as follows:

<u>Officer Of Grant</u>	<u>Purported Date</u> <u>Exercise Price</u>	<u>No. Of Options</u>	
Schroeder	7-31-97	\$30.2813	125,000
	8-31-98	10.625	204,272
	10-23-98	16.9688	220,728
	10-27-99	16.875	300,000
	8-13-00	44.6875	75,800
	11-10-00	26.25	37,900
	4-4-01	32.75	37,900
	10-2-01	29.31	341,100
Levy	7-31-97	\$30.2813	125,000
	8-31-98	10.625	204,272
	10-23-98	16.9688	220,728
	10-27-99	16.875	180,000
	8-13-00	44.6875	37,901
	11-10-00	26.25	18,951
	4-4-01	32.75	18,951
	10-2-01	29.31	28,425
Dickerson	7-31-97	\$30.2813	85,000
	8-31-98	10.625	125,764
	10-23-98	16.9688	139,236
	10-27-99	16.875	200,000
	8-13-00	44.6875	65,800
	11-10-00	26.25	32,500
	4-4-01	32.75	32,500
	10-2-01	29.31	105,000
Tompkins	8-31-98	\$10.625	101,618
	10-23-98	16.9688	148,382
	10-27-99	16.875	20,000
	11-10-00	26.25	10,000
Boehlke	7-31-97	\$10.625	667,000
	8-31-98	16.9688	108,870
	10-23-98	33.9375	99,300
	10-27-99	16.875	120,000

Schnitzer	8-31-98	\$10.625	108,870
	10-23-98	16.9688	99,300
	10-27-99	33.75	100,000
Kispert	10-2-01	\$29.31	60,000
Fortino	10-2-01	\$29.31	45,000

24. Despite the express requirements of the stock option plans and in violation thereof, each and every one of the stock option grants was back dated, at the date of grant, after a sharp drop in the stock price, and just before a substantial rise in KLA's stock price, to enable the recipients to be able to cash in on substantial profits.

25. On October 31, 1998, KLA announced that certain executive officers were granted the opportunity to surrender options and receive a reduced number of options having an exercise price of \$33.94 the market price on that date, pre-split. However, October 31, 1998 fell on a Saturday, and the closing pre-split price on Friday, October 30, 1998, was \$36.87.

26. Certain KLA executives took advantage of the opportunity and surrendered their options and received the following pre-split:

Kenneth Levy	110,364
Kenneth L. Schroeder	110,364
Gary E. Dickerson	69,618
Jon D. Tompkins	74,191
Robert J. Boehlke	49,065
Arthur P. Schnitzer	49,065
Edward C. Grady	26,745
Samuel A. Harrell	57,338
Neil Richardson	46,184

KLA reported that the date of grant in each instance for the above was October 23, 1998, and that the option exercise price was \$33.94. All of the above transactions were not adjusted for the split.

27. Pursuant to APB 25, the applicable GAAP provision at the time of the foregoing stock option grants, if the market price on the date of grant exceeds the exercise price of the options, the company must recognize the difference as an expense.

28. Pursuant to § 162(m) of the Tax Code, 26 U.S.C. §162(m), compensation in excess of \$1 million per year, including gains on stock options, paid to a corporation's five most highly-compensated officers is tax deductible only if: (i) the compensation is payable solely on account of the attainment of one or more performance goals; (ii) the performance goals are determined by a compensation committee comprised solely of two or more outside directors; (iii) the material terms under which the compensation is to be paid, including the performance goals, are disclosed to shareholders and approved by a majority of the vote in a separate shareholder vote before the payment of the compensation; and (iv) before any payment of such compensation, the compensation committee certifies that the performance goals and any other material terms were in fact satisfied.

29. Various of the defendants exercised their options as follows:

(a) Defendant Schroeder exercised options received between July 1997 and October 2001. He obtained 550,000 shares upon such exercise;

(b) Defendant Levy exercised options received between July 1997 and October 2001. He obtained 275,000 shares upon such exercise;

(c) Defendant Tompkins exercised options received between 1998 and 2000. He obtained 280,000 shares upon such exercise;

(d) Defendant Dickerson exercised options received between 1997 and 2001. He obtained 327,535 shares upon such exercise;

(e) Defendant Kispert exercised options received in 2001. He obtained 46,000 shares upon such exercise;

(f) Defendant Fortino exercised options granted to him in October 2001. He obtained 20,250 shares upon such exercise.

30. Other defendants and officers and directors similarly received options that were void because they were not priced on the grant date and exercised, and continue to exercise those options and receive stock therefor. The names and amounts are still unknown and will be ascertained upon complete discovery.

31. To conceal the issuance of the improperly priced and thus void options, and the violation of the stock option plans, KLA was caused to claim deductions under the aforesaid tax code, to state improperly its financial results, and never disclosed to shareholders that the options had been improperly priced and back dated. Indeed, KLA falsely reported the option grant dates in their annual reports and disseminated the false

information to the shareholders and in the SEC filings. Shareholders never learned the truth until now.

32. Thereafter, as a result of publicity regarding a number of public companies having "back dated" options, KLA examined the circumstance and conceded in press releases that it had improperly priced its options. This publicity was the first time and first indication that such "back dating" had occurred, in violation of the stock option plans.

33. After the conclusion of the investigation, KLA determined that particular options had indeed, fair market prices below those on the date they were granted.

34. During December 26, 2006 to December 28, 2006, KLA entered into Agreements with Richard Wallace, Neil Richardson and defendant Dennis Fortino whereby the exercise price of their respective options were raised as follows:

<u>Name</u>	<u>Prior Exercise Price</u>	<u>Increased Exercise Price</u>
<u>Richard Wallace</u>	<u>\$26.26</u>	<u>\$32.88</u>
<u>Neil Richardson</u>	<u>\$32.75</u>	<u>\$50.82</u>
<u>Dennis Fortino</u>	<u>\$29.31</u>	<u>\$45.25</u>

35. As part of their agreement, each of the foregoing recipients will receive a special cash bonus from KLA equal to the amount of the aggregate increase in the exercise price. Thus, Mr. Wallace would receive or has received a cash payment of \$21,275.67. Mr. Richardson would receive or has received a cash payment of \$84,332.69 and defendant Fortino would receive or has received a cash payment of \$263,010.00.

3336. KLA and its shareholders have been damaged as a direct result of the foregoing misconduct. There will be substantial tax liabilities and possible damages to be paid to potential class action suits already commenced and to be commenced. In addition to the said cash payments, there will be the loss of funds to be paid upon the exercise of the options and damage to KLA's good name and good will. The cash payment alleged above were improper and designed to enable the recipients to offset the increased option prices.

AS AND FOR A FIRST CAUSE OF ACTION
(Derivative)

3437. Plaintiff brings this suit as a derivative action in the right and for the benefit of KLA to address the injuries suffered and to be suffered by KLA as a result of the breached of fiduciary duty and commission of waste by the individual defendants.

3538. As a result of the facts set forth above, plaintiff has not made any demand on KLA's board of directors to institute this action against the individual defendants for the following reasons:

(a) Schroeder, Levy and Tompkins, are directly interested in the improperly backdated stock option grants complained of herein;

(b) Urbanek, Barholt and Bond, members of the Compensation Committee, directly participated in and approved the improper backdating of stock options, as alleged herein. Moreover, by colluding with the Officer Defendants and others, as

alleged herein, Urbanek, Barnholt, and Bond have demonstrated that they are unable or unwilling to act independently of the Officer Defendants;

(c) Bond, Elkus, and Bingham, members of the Audit Committee directly participated in and approved the Company's violations of GAAP and the Tax Code as alleged herein. Moreover, by colluding with the Officer Defendants and others, as alleged herein, Bond, Elkus, and Bingham have demonstrated that they are unable or unwilling to act independently of the Officer Defendants;

(d) Urbanek, Barnholt, Bond, Elkus, and Bingham, directors of the Company directly participated in and approved the Company's filing of false financial statements and other SEC filings, as alleged herein. Moreover, by colluding with the Officer Defendant and others, as alleged herein, Bond, Elkus, and Bingham have demonstrated that they are unable or unwilling to act independently of the Officer Defendants.

(e) The acts complained of herein resulted from failure to follow the stockholder approved option plans and the resulting exercise of those options and the issuance of the stock thereunder constituted acts of *ultra vires*, for which demand is excused;

(f) The Board of directors currently consists of ten directors, of which eight were involved, either in receiving the options as set forth above, or being aware of the granting, and overlooking the back dating of said options;

(g) The acts complained of herein constitute waste, if nothing else and are thus incapable of being considered the exercise of business judgment;

(h) The Board is incapable of exercising an independent and disinterested decision to institute and prosecute this action and the complained of acts could not be, and were not the result of any exercise of good faith business judgment.

(i) Moreover, the Board will itself become defendants in any pending action or other litigations to be instituted for the aforesaid misconduct.

AS AND FOR A SECOND CAUSE OF ACTION
(Class)

3639. This claim is asserted as an individual and class claim on behalf of all KLA shareholders.

3740. Defendants caused the shareholders' equity and holdings to be diluted and wasted by allowing void options to be granted on a date other than the grant date and at an exercise price lower than the grant date exercise price, in violation of the stockholder approved option plans and upon the exercise of said options, causing KLA to receive less than the required consideration. Thus, the equity of all KLA shareholders were improperly diluted.

3841. Plaintiff will fairly and adequately represent the shareholders in this litigation.

WHEREFORE, plaintiff demands judgment as follows:

- A. Against all of the individual defendants and in favor of KLA for the damages sustained by KLA and/or its shareholders as a result of the actions complained of herein;
- B. Ordering the recipients to disgorge to KLA all of the back dated options they received, including the proceeds of any such options that have been exercised, sold, pledged or otherwise monetized;
- C. Granting such other and appropriate equitable relief to remedy the wrongs complained of herein;
- D. Awarding to plaintiff the costs and disbursements of this action, including reasonable attorneys' fees, accountants' and experts' fees, costs and disbursements; and
- E. Such other and further relief as the Court deems just and proper.

Dated: ~~7/21/2006~~ March 5, 2007

BIGGS AND BATAGLIA

By: /s/ Robert Goldberg
Robert Goldberg (I.D. No. 631)
Biggs and Bataglia
921 North Orange Street
P.O. Box 1489
Wilmington, DE 19899
(302) 655-9677
Attorney for Plaintiff

Of Counsel:

Of Counsel:

Irving Bizar, Esq.
Ballon Stoll Bader & Nadler, P.C.
1450 Broadway, 14th floor
New York, NY 10018
T: (212) 575-7900
F: (212) 764-5060

CERTIFICATE OF SERVICE

I, Robert D. Goldberg, undersigned counsel of record, hereby certify that on March 5, 2007, I caused a copy of the Amended Complaint of Benjamin Langford to be served on the following in the manner indicated:

VIA ELECTRONIC FILING

Michael D. Goldman (ID #268)
Hercules Plaza, 6th Floor
1313 N. Market Street
Wilmington, DE 19899-0951

/s/ Robert D. Goldberg
Robert D. Goldberg (I.D. #631)

EXHIBIT 2

SAH A & A LEGAL SERVICE 6506974640

NO. 8658 P. 1

ORIGINAL

UCS

1 WEISS & LURIE
Jordan L. Lurie (130013)
2 Leigh A. Parker (170565)
Zev B. Zysman (176805)
3 10940 Wilshire Boulevard, 23rd Floor
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6 Counsel for Plaintiff

FILED Santa Clara Co
06/02/08 2:10PM
Kiri Torre
Chief Executive Officer
By: shannon dtclerk
R#2006000543/0
\$87.00
IL \$87.00
Case: 1-06-CV-064841

7
8 SUPERIOR COURT OF THE STATE OF CALIFORNIA
9 FOR THE COUNTY OF SANTA CLARA

11 JEFFREY A. RABIN, Derivatively on Behalf of
Nominal Defendant KLA-TENCOR
12 CORPORATION,

13 Plaintiff,

14 v.

15 EDWARD W. BARNHOLT, H. RAYMOND
BINGHAM, ROBERT J. BOEHLKE, ROBERT
16 T. BOND, GARY E. DICKERSON, RICHARD
J. ELKUS, JR., DENNIS J. FORTINO, JOHN
17 H. KISPert, KENNETH LEVY, ARTHUR P.
SCHNITZER, KENNETH L. SCHROEDER,
18 JON D. TOMPKINS, and LIDA URBANEK,

19 Defendants,

20 and

21 KLA-TENCOR CORPORATION,

22 Nominal Defendant.

Case No. 106CV064841

CLASS ACTION FILE VIA FAX

VERIFIED SHAREHOLDER
DERIVATIVE COMPLAINT

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DERIVATIVE COMPLAINT

1 Plaintiff, by his attorneys, submits this Derivative Complaint (the "Complaint") against
2 the defendants named herein.

3 **NATURE AND SUMMARY OF THE ACTION**

4 1. This is a shareholder's derivative action brought for the benefit of nominal
5 defendant KLA-Tencor Corporation ("KLA" or the "Company") against certain members of its
6 Board of Directors (the "Board"), including members of the Company's Compensation
7 Committee and the Company's Audit Committee, and certain of the Company's executive
8 officers.

9 2. When stock options are awarded, the strike price of the options ordinarily is set
10 equal to or below the share price on the day of the award. In this way, the executives of a
11 company are supposed to have their interests aligned with the shareholders, whose holdings are
12 diluted each time an option is exercised.

13 3. As further alleged below, Defendants improperly backdated stock option grants to
14 make it appear as though the grants were made on dates when the market price of KLA stock was
15 lower than the market price on the actual grant dates. This improper backdating resulted in option
16 grants with lower exercise prices and thereby improperly increased the value of the options to the
17 Officer Defendants, improperly reduced the amounts the Officer Defendants had to pay the
18 Company upon exercise of the options, and unfairly transferred shareholder equity to Defendants.
19 Defendants' conduct also violated the Company's shareholder-approved stock option plans, the
20 Company's corporate governance guidelines, the Company's standards of business conduct and
21 the Company's conflicts of interest policy.

22 4. Defendants' backdating scheme also rendered the Company's proxy materials
23 false and misleading, as the proxy materials falsely reported the dates of the stock option grants
24 and falsely represented that options were granted at fair market value; if the option grant is
25 backdated, the options value is not fair from the vantage point of the Company and its
26 shareholders. Further, Defendants' backdating of options grants violated provisions of the
27 Internal Revenue Code relating to deduction of option payments and thereby rendered the
28

1 Company's financial statements in Form 10-K filings for the years 1998, 1999, 2000, 2001, and
2 2002 false and misleading.

3 5. In addition, KLA and its shareholders were further injured in that Defendants'
4 illegal conduct caused KLA to overpay to acquire ADE Corporation, a maker of silicon wafer
5 inspection equipment, as further described below.

6 6. On May 24, 2006, KLA announced the formation of a Special Committee to
7 investigate the Company's stock option practices from 1995 to 2001. The Company also
8 announced that it received subpoenas from the U.S. Attorney's Office for the Eastern District of
9 New York and the Northern District of California requesting information relating to the
10 Company's past stock option grants.

11 7. As a result of Defendants' conduct, the Company's stock price has declined and
12 the Company has sustained millions of dollars in damages, including additional compensation
13 expenses and tax liabilities and loss of funds paid to the Company upon exercise of options, and
14 the recipients of the backdated stock options have garnered millions of dollars in unlawful profits.

15 JURISDICTION AND VENUE

16 8. This Court has jurisdiction over all causes of action asserted herein because this
17 case is a cause not given by statute to other trial courts.

18 9. The jurisdiction of this Court arises under §410.10 of the Code of Civil Procedure.
19 This Court has jurisdiction over each of the Defendants in this action because they conduct
20 business in, reside in or are citizens of this State. The conduct alleged herein took place in and/or
21 was directed at residents of this State.

22 10. The amounts in controversy exceed the jurisdictional minimum of this Court.

23 11. Venue is proper in this Court because a substantial portion of the transactions and
24 wrongs complained of herein, including the Defendants' primary participation in the wrongful
25 acts detailed herein, occurred in this district, because Defendants have received substantial
26 compensation in this district by engaging in numerous activities and conducting business here,
27 which had an effect in this district, and because KLA maintains its principal place of business in
28

1 this County. Defendant KLA maintains its principal place of business at 160 Rio Robles, San
2 Jose, California 95134.

3 **PARTIES**

4 12. Plaintiff Jeffrey A. Rabin, a citizen of the State of California, is, and was at all
5 relevant times, a shareholder of KLA.

6 13. Nominal defendant KLA is a Delaware corporation with its principal executive
7 offices located at 160 Rio Robles, San Jose, California 95134. According to its public filings,
8 KLA is a supplier of process control and yield management solutions for the semiconductor
9 manufacturing and related microelectronics industries. KLA's stock is publicly traded on the
10 Nasdaq under the ticker symbol KLAC.

11 14. Defendant Kenneth L. Schroeder ("Schroeder") has served as a director of KLA
12 and as Chief Executive Officer of the Company since July 1999. Schroeder served as President
13 of the Company from November 1991 to July 2002 and again from May 2004 to July 2005.

14 15. Defendant Kenneth Levy ("Levy"), a founder of KLA, has served as a director of
15 KLA since 1975 and as Chairman of the Board since July 1999. Levy served as Chief Executive
16 Officer of the Company from July 1998 to June 1999.

17 16. Defendant Jon D. Tompkins ("Tompkins") has served as a director of KLA since
18 April 7, 1997. Tompkins served as Chairman of the Board from July 1998 to June 1999 and as
19 Chief Executive Officer of the Company from May 1997 to July 1998.

20 17. Defendant Robert J. Boehlke ("Boehlke") served as Executive Vice President and
21 Chief Financial Officer of the Company from 1992 to 2000.

22 18. Defendant Gary B. Dickerson ("Dickerson") served as Executive Vice President of
23 the Company from 1995 to 1999 and as President and Chief Operating Officer of the Company
24 from 1999 to 2004.

25 19. Defendant Arthur P. Schnitzer ("Schnitzer") served as Executive Vice President of
26 the Company at all times relevant hereto.

27 20. Defendant John H. Kispert ("Kispert") has served as Executive Vice President and
28 Chief Financial Officer of the Company since 2000.

1 21. Defendant Dennis J. Fortino ("Fortino") has served as Executive Vice President
2 of the Company since 1999.

3 22. Collectively, defendants Schroeder, Levy, Tompkins, Boehlke, Dickerson,
4 Schlitzer, Kispert, and Fortino are referred to herein as the "Officer Defendants."

5 23. Defendant Lida Urbanek ("Urbanek") has served as a director of KLA and as a
6 member of the Compensation Committee of the Board (the "Compensation Committee") since
7 1997.

8 24. Defendant Edward W. Barnholt ("Barnholt") has served as a director of KLA
9 since 1995 and as a member of the Compensation Committee since 2000.

10 25. Defendant Robert T. Bond ("Bond") has served as a director of KLA and as a
11 member of the Compensation Committee since 2000. Bond has also served as a member of the
12 Audit Committee of the Board (the "Audit Committee") since 2002.

13 26. Collectively, defendants Urbanek, Barnholt, and Bond are referred to herein as the
14 "Compensation Committee Defendants." At all times relevant hereto, the Compensation
15 Committee determined the salaries, incentive compensation, and stock option awards for
16 executive officers of KLA and administered the Company's stock option plans.

17 27. Defendant Richard J. Elkus, Jr. ("Elkus") has served as a director of KLA since
18 1997 and as a member of the Audit Committee since 1999.

19 28. Defendant H. Raymond Bingham ("Bingham") has served as a director of KLA
20 since 1999 and as a member of the Audit Committee since 2000.

21 29. Collectively, defendants Bond, Elkus, and Bingham are referred to herein as the
22 "Audit Committee Defendants." At all times relevant hereto, the Audit Committee supervised
23 the preparation, filing and/or dissemination of the Company's financial statements, including the
24 treatment of stock option awards for executive officers of KLA.

25 30. At all relevant times, defendants Barnholt and Elkus also served on the
26 Company's Nominating and Governance Committee which is charged with reviewing the
27 Company's corporate governance policies and procedures.

28

1 31. Collectively, the Officer Defendants, Compensation Committee Defendants, and
2 Audit Committee Defendants are referred to herein as the "Individual Defendants" or as
3 "Defendants."

4 **DUTIES OF THE INDIVIDUAL DEFENDANTS**

5 32. Each Individual Defendant owed and owes KLA and its shareholders fiduciary
6 obligations and were and are required by law to: (1) use their ability to control and manage KLA
7 in a fair, just and equitable manner; (2) act in furtherance of the best interests of KLA and its
8 shareholders; (3) act to maximize shareholder value in connection with any transaction; (4)
9 govern KLA in such a manner as to heed the expressed views of its public shareholders; (5)
10 refrain from abusing their positions of control; and (6) not favor their own interests or the
11 interests of any Individual Defendants at the expense of KLA and its public shareholders.

12 33. By reason of their positions as officers and/or directors of the Company and
13 because of their ability to control the business and corporate affairs of the Company, the
14 Individual Defendants owed the Company and its shareholders the fiduciary obligations of good
15 faith, trust, loyalty, and due care, and were and are required to use their utmost ability to control
16 and manage the Company in a fair, just, honest, and equitable manner. The Individual Defendants
17 were and are required to act in furtherance of the best interests of the Company and its
18 shareholders so as to benefit all shareholders equally and not in furtherance of their personal
19 interest or benefit. Each director and officer of the Company owes to the Company and its
20 shareholders the fiduciary duty to exercise good faith and diligence in the administration of the
21 affairs of the Company and in the use and preservation of its property and assets, and the highest
22 obligations of fair dealing.

23 34. The Individual Defendants, because of their positions of control and authority as
24 directors and/or officers of the Company, were able to and did, directly and/or indirectly, exercise
25 control over the wrongful acts complained of herein and did control and influence and cause KLA
26 to engage in the practices complained of herein.

27 35. Each defendant herein is sued individually as a conspirator and aider and abettor,
28 as well as in his capacity as a director of KLA, and the liability of each arises from the fact that

1 each engaged in and/or aided and abetted all or part of the unlawful acts, plans or transactions
 2 complained of herein.

3 36. To discharge their duties, the officers and directors of the Company were required
 4 to exercise reasonable and prudent supervision over the management policies, practices and
 5 controls of the Company. By virtue of such duties, the officers and directors of the Company
 6 were required to, among other things:

- 7 a. exercise good faith in ensuring that the affairs of the Company were
 8 conducted in an efficient, business-like manner so as to make it possible to
 provide the highest quality performance of their business;
- 9 b. exercise good faith in ensuring that the Company was operated in a
 10 diligent, honest and prudent manner and complied with all applicable
 11 federal and state laws, rules, regulations and requirements, including acting
 only within the scope of its legal authority;
- 12 c. exercise good faith in supervising the preparation, filing and/or
 13 dissemination of financial statements, press releases, audits, reports or
 14 other information required by law, and in examining and evaluating any
 reports or examinations, audits, or other financial information concerning
 the financial condition of the Company;
- 15 d. exercise good faith in ensuring that the Company's financial statements
 16 were prepared in accordance with Generally Accepted Accounting
 Principles ("GAAP"); and
- 17 e. refrain from unduly benefitting themselves and other Company insiders at
 the expense of the Company.

18 37. The Individual Defendants also were responsible for maintaining and establishing
 19 adequate internal accounting controls for the Company and to ensure that the Company's financial
 20 statements were based on adequate accurate financial information. According to GAAP, to
 21 accomplish the objectives of accurately recording, processing, summarizing, and reporting
 22 financial data, a corporation must establish an internal accounting control structure. Among other
 23 things, the Individual Defendants were required to:

- 24 (1) make and keep books, records, and accounts, which, in reasonable detail,
 25 accurately and fairly reflect the transactions and dispositions of the assets
 of the issuer; and
- 26 (2) devise and maintain a system of internal accounting controls sufficient to
 27 provide reasonable assurances that --
 28 (a) transactions are executed in accordance with management's general
 or specific authorization;

(b) transactions are recorded as necessary to permit preparation of financial statements in conformity with [GAAP].

38. Further, KLA's Audit Committee Charter provides that the Audit Committee shall be responsible for, among other things:

- a. Reviewing on a continuing basis the adequacy of the Company's system of internal controls, including meeting periodically with the Company's management and the independent auditors to review the adequacy of such controls and to review before release the disclosure regarding such system of internal controls required under SEC rules to be contained in the a Company's periodic filings and the attestations or reports by the independent auditors relating to such disclosure; and
- b. Reviewing and discussing with management and the independent auditors the annual audited financial statements and quarterly unaudited Financial Statements, including the Company's disclosures under "Management's Discussion and Analysis of Financial Condition" and "Results of Operations" to be included in the Company's Annual Report on Form 10K (or the Annual Report to Shareholders if distributed prior to the filing of Form 10K) and Quarterly Reports on Form 10-Q, respectively, prior to their filing with the SEC.

SUBSTANTIVE ALLEGATIONS

39. From 1997 to 2001, the Compensation Committee granted certain KLA stock options to the Officer Defendants as set forth in Exhibit A hereto. All of the grants were dated just after a sharp drop in the Company's stock price and just before a substantial rise in the Company's stock price. An analysis conducted by the *Wall Street Journal* and initially reported on March 18, 2006 found the probability that such a pattern occurred merely by chance to be around one in 20 million.

40. The reason for the extraordinary pattern of stock option grants as alleged herein is that the purported grant dates set forth therein were not the actual dates on which the stock option grants were made. Rather, at the behest of the Officer Defendants and /or other Individual Defendants, the Compensation Committee Defendants improperly backdated the stock option grants to make it appear as though the grants were made on dates when the market price of KLA stock was lower than the market price on the actual grant dates.

1 41. This improper backdating violated the terms of the Company's shareholder-
2 approved stock option plans. Pursuant to the terms of the Company's shareholder-approved stock
3 option plans, the exercise price of options must be no less than the closing price of KLA stock on
4 the date of grant. In this way, the executives of a company are supposed to have their interests
5 aligned with the shareholders, whose holdings are diluted each time an option is exercised.
6 Backdating improperly increased the value of the options to the Officer Defendants and gave
7 them an immediate paper profit which undermined the incentive purpose of such options,
8 improperly reduced the amounts the Officer Defendants had to pay the Company upon exercise of
9 the options, and unfairly transferred shareholder equity to Defendants.

10 42. Defendants' conduct also violated the terms of the Company's own corporate
11 governance guidelines, the Company's standards of business conduct and the Company's
12 conflicts of interest policy. For example, the Company's Corporate Governance Standards
13 provides that "each director owes a duty of loyalty to the Company and is expected to act in the
14 best interests of the Company and its stockholders as a whole." Similarly, the Company's
15 Standards of Business Conduct states, in part, that "KLA-Tencor insists that all records
16 maintained by employees are an accurate, honest and forthright presentation of the facts."
17 KLA's conflict of interest policy, as set forth in the Company's proxy statement states that
18 "KLA-Tencor expects its Directors, executives and employees to conduct themselves with the
19 highest degree of integrity, ethics and honesty."

20 43. Defendants' backdating scheme also rendered the Company's proxy materials
21 from 1997 to 2005 false and misleading, as the proxy materials falsely reported the dates of the
22 stock option grants and falsely represented that the options were granted at fair market value; if
23 the option grant is backdated, the options value is not fair from the vantage point of the Company
24 and its shareholders. For example, a report of the Compensation Committee contained in KLA's
25 2002 proxy statement falsely stated that "Stock options are granted at market prices on the date of
26 grant and will provide value to the executive officers only when the price of the Company's
27 Common Stock increases over the exercise price." Defendants also filed with the SEC Form 4
28 filings that falsely reported the dates of stock option grants to the Officer Defendants.

1 44. Defendants' backdating scheme also rendered the Company's financial statements
2 in Form 10-K filings for the years 1998, 1999, 2000, 2001, and 2002 false and misleading.

3 45. Pursuant to APB 25, the applicable GAAP provision at the time of the foregoing
4 stock option grants, if the market price on the date of grant exceeds the exercise price of the
5 options, the company must recognize the difference as an expense, reducing the company's net
6 income.

7 46. In addition, as set forth in the Company's proxy statement, the Company has
8 adopted the IRS §162(m) (Section 162(m) of the Tax Code, 26 U.S.C. §162) Performance Bonus
9 Plan which permits the Company to deduct for federal income taxes purposes compensation paid
10 under the Bonus Plan. Pursuant to Section 162(m), compensation in excess of \$1 million per
11 year, including gains on stock options, paid to a corporation's five most highly-compensated
12 officers is tax deductible only if: (i) the compensation is payable solely on account of the
13 attainment of one or more performance goals; (ii) the performance goals are determined by a
14 compensation committee comprised solely of two or more outside directors, (iii) the material
15 terms under which the compensation is to be paid, including the performance goals, are disclosed
16 to shareholders and approved by a majority of the vote in a separate shareholder vote before
17 payment of the compensation, and (iv) before any payment of such compensation, the
18 compensation committee certifies that the performance goals and any other material terms were
19 in fact satisfied.

20 47. As a result of the improper backdating of stock options, the Company, with the
21 knowledge, approval, and participation of each of the Individual Defendants, violated GAAP by
22 failing to recognize compensation expenses incurred when the improperly backdated options
23 were granted; violated §162(m) by taking tax deductions based on stock option grants that were
24 not payable solely on account of the attainment of one or more performance goals and violated
25 the terms of the Company's shareholder-approved stock option plans; and produced and
26 disseminated to KLA shareholders and the market false financial statements that improperly
27 recorded and accounted for the backdated option grants, rendering the Company's financial
28 statements false and misleading.

1 48. As a result of all of the foregoing, KLA has been damaged. KLA's stock price has
2 declined over 20% or over \$10 per share since news of the scandal first surfaced, and it will likely
3 cost the Company millions of dollars to resolve the multiple stock option investigations and
4 lawsuits.

5 49. In addition, the Company and its shareholders were further injured in that
6 Defendants' illegal conduct caused KLA to alter the terms of its offer to buy ADE, a maker of
7 silicon wafer inspection equipment and to overpay for the acquisition.

8 50. On February 23, 2006, KLA announced it was buying ADE in a stock-for-stock
9 transaction. As KLA shares wilted over the investigation of improprieties concerning KLA's
10 stock option grants, KLA was forced to change its purchase agreement from all stock to an all
11 cash offer as announced on May 26, 2006. As one commentator has noted, "I have to wonder
12 whether the latest decline [in KLA's stock price] caused by that [Wall Street Journal] column
13 finally pushed ADE's board to ask for a better deal. . . [KLA's offer] may be a higher price than it
14 had to be."

15 **THE INDIVIDUAL DEFENDANTS' BREACHES OF FIDUCIARY DUTIES**

16 51. The Officer Defendants breached their fiduciary duties by, *inter alia*:

- 17 a. colluding with the Compensation Committee Defendants to improperly
18 backdate dozens of grants of KLA stock options to KLA Chief Executive
19 Officer Kenneth L. Schroeder and several other KLA executives, in
20 violation of the Company's shareholder-approved stock option plans;
- 21 b. colluding with the Audit Committee Defendants to improperly record and
22 account for the backdated stock options, in violation of Generally
23 Accepted Accounting Principles and improperly take tax deductions based
24 on the backdated stock options, in violation of Section 162(m) of the Tax
25 Code;
- 26 c. colluding with the other Individual Defendants to produce and disseminate
27 to KLA shareholders and the market false financial statements that
28 improperly recorded and accounted for the backdated option grants and
concealed the improper backdating of stock options; and
- d. colluding with the other Individual Defendants to file false proxy
statements and false Form 4 filings in order to conceal the improper
backdating of stock options.

1 52. The Officer Defendants' foregoing misconduct was not, and could not have been,
2 an exercise of good faith business judgment. Rather, it was intended to, and did, unduly benefit
3 the Officer Defendants at the expense of the Company.

4 53. The Compensation Committee Defendants breached their fiduciary duties by,
5 *inter alia*:

- 6 a. colluding with the Officer Defendants to backdate stock option grants;
- 7 b. colluding with the Officer Defendants and Audit Committee Defendants to
8 violate GAAP and Section 162(m);
- 9 c. colluding with the other Individual Defendants to produce and disseminate
10 to KLA shareholders and the market false financial statements that
11 improperly recorded and accounted for the backdated option grants and
12 concealed the improper backdating of stock options; and
- 13 d. colluding with the other Individual Defendants to file false proxy
14 statements and false Form 4 filings in order to conceal the improper
15 backdating of stock options.

16 54. The Compensation Committee Defendants' foregoing misconduct was not, and
17 could not have been, an exercise of good faith business judgment. Rather, it was intended to, and
18 did, unduly benefit the Officer Defendants at the expense of the Company.

19 55. The Audit Committee Defendants breached their fiduciary duties by, *inter alia*:

- 20 a. colluding with the Officer Defendants to violate GAAP and Section
21 162(m);
- 22 b. colluding with the other Individual Defendants to produce and disseminate
23 to KLA shareholders and the market false financial statements that
24 improperly recorded and accounted for the backdated option grants and
25 concealed the improper backdating of stock options; and
- 26 c. colluding with the other Individual Defendants to file false proxy
27 statements and false Form 4 filings in order to conceal the improper
28 backdating of stock options.

29 56. The Audit Committee Defendants' foregoing misconduct was not and could not
30 have been, an exercise of good faith business judgment. Rather, it was intended to, and did,
31 unduly benefit the Officer Defendants at the expense of the Company.

32 57. As a direct and proximate result of the Individual Defendants' foregoing breaches
33 of fiduciary duties, the Company has sustained millions of dollars in damages, including, but not

1 limited to, the additional compensation expenses and tax liabilities the Company was required to
 2 incur and loss of funds paid to the Company upon exercise of options.

3 DERIVATIVE AND DEMAND EXCUSED ALLEGATIONS

4 58. Plaintiff brings this action derivatively in the right and for the benefit of the
 5 Company to redress Defendants' breaches of fiduciary duties and unjust enrichment.

6 59. Plaintiff is an owner of KLA common stock and was an owner of KLA common
 7 stock at all times relevant hereto.

8 60. Plaintiff will adequately and fairly represent the interests of the Company and its
 9 shareholders enforcing and prosecuting its rights.

10 61. As a result of the facts set forth herein, plaintiff has not made any demand on the
 11 KLA Board of Directors to institute this action against the Individual Defendants. Such demand
 12 would be a futile and useless act because the Board is incapable of making an independent and
 13 disinterested decision to institute and vigorously prosecute this action.

14 62. The Board currently consists of 10 directors: defendants Schroeder, Levy,
 15 Tompkins, Barnholt, Bingham, Bond, Elkus, and Urbanek, and directors Michael E. Marks and
 16 Stephen P. Kaufman. The following directors are incapable of independently and disinterestedly
 17 considering a demand to commence and vigorously prosecute this action:

- 18 a. Schroeder, Levy, and Tompkins, because they are directly interested in the
 19 improperly backdated stock option grants complained of herein;
- 20 b. Urbanek, Barnholt, and Bond, because as members of the Compensation
 21 Committee they directly participated in and approved the improper
 22 backdating of stock options, as alleged herein, and face substantial
 23 likelihood of liability for their conduct. Moreover, by colluding with the
 24 Officer Defendants and others, as alleged herein, Urbanek, Barnholt, and
 25 Bond have demonstrated that they are unable or unwilling to act
 26 independently of the Officer Defendants;
- 27 c. Bond, Elkus, and Bingham, because as members of the Audit Committee
 28 they directly participated in and approved the Company's violations of
 GAAP and Section 162(n), as alleged herein. Moreover, by colluding with
 the Officer Defendants and others, as alleged herein, Bond, Elkus, and
 Bingham have demonstrated that they are unable or unwilling to act
 independently of the Officer Defendants;
- d. Urbanek, Barnholt, Bond, Elkus, and Bingham, because as directors of the
 Company they directly participated in and approved the Company's filing
 of false financial statements and other SEC filings, as alleged herein.

Moreover, by colluding with the Officer Defendants and others, as alleged herein, Bond, Elkus, and Bingham have demonstrated that they are unable or unwilling to act independently of the Officer Defendants;

- e. If the current directors were to bring this derivative action against themselves, they would thereby expose their own misconduct, which may underlie allegations against them in class action complaints for violations of the securities law, which admissions would impair their defense of any class actions filed and greatly increase any insurance coverage available to the Individual Defendants. In essence, they would be forced to take positions contrary to the defense they will likely assert in any securities class actions. This they will not do. Thus, demand is futile.

63. Furthermore, demand is excused because the misconduct complained of herein was not, and could not have been, an exercise of good faith business judgment.

64. A true and correct copy of this complaint was delivered to KLA before being filed with this Court.

**FIRST CAUSE OF ACTION
(Against All Individual Defendants for Breach of Fiduciary Duty)**

65. Plaintiff incorporates by reference all preceding and subsequent paragraphs as if set forth fully herein.

66. As alleged in detail herein, each of the Individual Defendants had a fiduciary duty to refrain from unduly benefitting themselves and other Company insiders at the expense of the Company.

67. As alleged in detail herein, the Officer Defendants, Compensation Committee Defendants, and the Audit Committee Defendants breached their fiduciary duties by:

- a. colluding to backdate stock option grants;
- b. colluding to violate GAAP and Section 162(m);
- c. colluding to produce and disseminate to KLA shareholders and the market false financial statements that improperly recorded and accounted for the backdated option grants and concealed the improper backdating of stock options;
- d. colluding to file false proxy statements and false Form 4 filings in order to conceal the improper backdating of stock options; and
- e. violating the provisions of the Company's own internal corporate governance guidelines, the Company's standards of business conduct and the Company's conflicts of interest policy.

68. Defendants' foregoing misconduct was not, and could not have been, an exercise of good faith business judgment. Rather, it was intended to, and did, unduly benefit the Officer Defendants at the expense of the Company.

69. As a direct and proximate result of the Individual Defendants' foregoing breaches of fiduciary duties, the Company has sustained millions of dollars in damages, including, but not limited to, the additional compensation expenses and tax liabilities the Company was required to incur and loss of funds paid to the Company upon exercise of options.

SECOND CAUSE OF ACTION
(Against All Individual Defendants)
For Negligent Breaches of Fiduciary Duty

70. Except to the extent plaintiff alleges intentional or reckless misconduct by any Defendant, plaintiff incorporates by reference all preceding and subsequent paragraphs if set forth fully herein.

71. The Individual Defendants engaged in the aforesaid conduct without exercising the reasonable and ordinary care owed to the Company by directors, officers, managing agents and employees of a company.

72. The Company and its shareholders have been injured by reason of the Individual Defendants' negligent breaches of their fiduciary duty.

THIRD CAUSE OF ACTION
(Against the Officer Defendants for Unjust Enrichment)

73. Plaintiff incorporates by reference all preceding and subsequent paragraphs as if set forth fully herein.

74. The Officer Defendants were unjustly enriched by their receipt and retention of backdated stock option grants, as alleged herein, and it would be unconscionable to allow them to retain the benefits thereof.

75. To remedy the Officer Defendants' unjust enrichment, the Court should order them to disgorge to the Company all of the backdated stock options they received, including the proceeds of any such options that have been exercised, sold, pledged, or otherwise monetized.

1 **FOURTH CAUSE OF ACTION**
2 **(Against All Individual Defendants for Abuse of Control)**

3 76. Plaintiff incorporates by reference all preceding and subsequent paragraphs as if
4 set forth fully herein.

5 77. Defendants' conduct constituted an abuse of their ability to control and influence
6 KLA for which they are legally responsible.

7 78. By reason of the foregoing, KLA has been damaged.

8 **FIFTH CAUSE OF ACTION**
9 **(Against All Individual Defendants for Constructive Fraud)**

10 79. Plaintiff incorporates by reference all preceding and subsequent paragraphs as if
11 set forth fully herein.

12 80. As a result of the conduct described above, Defendants have committed, or aided
13 and abetted the commission of numerous representations to and concealed material facts from
14 KLA despite Defendants' fiduciary duties to, *inter alia*, disclose the true facts regarding their
15 stewardship of and their true intentions, and thus have committed and/or aided and abetted
16 constructive fraud.

17 81. For the purpose of maintaining and further entrenching themselves in their
18 positions of power and control at KLA and to attempt to conceal their wrongdoing and continue
19 to receive the substantial benefits and salaries associated with their positions, and with the intent
20 to injure KLA, Defendants employed the above-detailed scheme and conspiracy to defraud. As a
21 part of this scheme and conspiracy, Defendants actively made or concealed and/or participated in
22 the making of or aided and abetted the making or perpetration of the concealment, numerous
23 omissions and misrepresentations of facts to KLA. Said representations and statements were
24 untrue and Defendants did not believe them to be true when made, or knowingly, willfully, and/or
25 intentionally made them without regard to their truthfulness or aided and abetted the making of
26 said misrepresentations. Said acts by these Defendants were fraudulent, oppressive, despicable
27 and malicious.
28

1 82. By reason of the foregoing, KLA has sustained, and will continue to sustain,
2 irreparable injury for which it has no adequate remedy at law, and is also entitled to an award of
3 punitive damages against Defendants.

4 83. By reason of the foregoing, KLA has been damaged.

5 **SIXTH CAUSE OF ACTION**
6 **(Against All Defendants for Gross Mismanagement)**

7 84. Plaintiff incorporates by reference all preceding and subsequent paragraphs as if
8 set forth fully herein.

9 85. As detailed more fully herein, Defendants had a duty to KLA to prudently
10 supervise, manage and control KLA's operations.

11 86. Defendants by their actions, either directly or through aiding and abetting,
12 abandoned and abdicated their responsibilities and duties with regard to prudently managing the
13 assets of KLA in a manner consistent with the operations of a publicly-held corporation.

14 87. By acting as alleged herein, Defendants breached their duties of due care and
15 diligence in the management and administration of KLA's affairs and in the use and preservation
16 of KLA's assets.

17 88. As a proximate result thereof, KLA has been damaged.

18 **WHEREFORE**, Plaintiff demands judgment as follows:

19 A. Against all of the Individual Defendants and in favor of the Company for the
20 amount of damages sustained by the Company as a result of the Individual Defendants' breaches
21 of fiduciary duties and statutory violations;

22 B. Ordering the Officer Defendants to disgorge to the Company all of the backdated
23 stock options they received, including the proceeds of any such options that have been exercised,
24 sold, pledged, or otherwise monetized;

25 C. Granting appropriate equitable relief to remedy Defendants' breaches of
26 fiduciary duties;

27 D. Awarding to plaintiff the costs and disbursements of the action, including
28 reasonable attorneys' fees, accountants' and experts' fees, costs, and expenses; and

1 E. Granting such other and further relief as the Court deems just and proper.
2

3 **JURY TRIAL DEMANDED**

4 Plaintiff demands a trial by jury as to all issues so triable.
5

6 Dated: June 1, 2006

WEISS & LURIE

Jordan L. Lurie
Leigh A. Parker
Zev B. Zysman

7
8
9 By: 

Jordan L. Lurie
10940 Wilshire Boulevard, 23rd Floor
Los Angeles, CA 90024
Telephone: 310/208-2800
Facsimile: 310/209-2348

Attorneys for Plaintiff

EXHIBIT A

KLA-Tencor Stock Options (1997 thru 2001)			
	Purported Grant Date	Number of Options ¹	Exercise Price
SCHROEDER	07/31/97	62,500	\$60.5625
	08/31/98	102,136	\$21.2500
	10/23/98	110,364	\$33.9375
	10/27/99	150,000	\$33.7500
	08/13/00	75,800	\$44.6875
	11/10/00	37,900	\$26.2500
	04/04/01	37,900	\$32.7500
	10/02/01	341,100	\$29.3100
LEVY	07/31/97	62,500	\$60.5625
	08/31/98	102,136	\$21.2500
	10/23/98	110,364	\$33.9375
	10/27/99	90,000	\$33.7500
	08/13/00	37,901	\$44.6875
	11/10/00	18,951	\$26.2500
	04/04/01	18,951	\$32.7500
	10/02/01	28,425	\$29.3100
TOMPKINS	08/31/98	50,809	\$21.2500
	10/23/98	74,191	\$33.9375
	10/27/99	10,000	\$33.7500
	11/10/00	10,000	\$26.2500
BOEHLKE	07/31/97	33,500	\$60.5625
	08/31/98	54,435	\$21.2500

¹ Exercise prices and numbers of options are not adjusted for the Company's 2-for-1 stock split effective January 19, 2000.

KLA-Tencor Stock Options (1997 thru 2001)			
	10/23/98	49,065	\$33.9375
	10/27/99	60,000	\$33.7500
DICKERSON	07/31/97	42,500	\$60.5625
	08/31/98	62,882	\$21.2500
	10/23/98	69,618	\$33.9375
	10/27/99	100,000	\$33.7500
	08/13/00	65,000	\$44.6875
	11/10/00	32,500	\$26.2500
	04/04/01	32,500	\$32.7500
	10/02/01	105,000	\$29.3100
SCHNITZER	08/31/98	54,435	\$21.2500
	10/23/98	49,065	\$33.9375
	10/27/99	50,000	\$33.7500
KISPERT	10/02/01	60,000	\$29.3100
FORTINO	10/02/01	45,000	\$29.3100

A & A LEGAL SERVICE 6506974640

NO. 8658 P. 2

VERIFICATION

I, JEFFREY A. RABIN, hereby verify that I have reviewed the Complaint and authorized its filing and that the foregoing is true and correct to the best of my knowledge, information and belief.

Dated: June 1, 2006

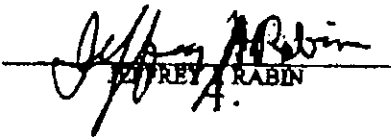

JEFFREY A. RABIN

EXHIBIT 3
Part 1 of 3

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7 Lead Counsel for Plaintiffs

8 [Additional counsel appear on signature page.]

9 UNITED STATES DISTRICT COURT
10 NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION

11 In re KLA-TENCOR CORP. SHAREHOLDER) No. C-06-03445-JW
DERIVATIVE LITIGATION)

12)
13 This Document Relates To:)

14 ALL ACTIONS.)

15 ALASKA ELECTRICAL PENSION FUND,
Derivatively on Behalf of KLA-TENCOR
16 CORPORATION,

Plaintiff,

17 vs.)

18 KENNETH LEVY, KENNETH L.
SCHROEDER, RICHARD P. WALLACE,
19 JOHN H. KISPERT, JEFFREY L. HALL, JON
D. TOMPKINS, LIDA URBANEK, H.
20 RAYMOND BINGHAM, ROBERT J.
BOEHLKE, ROBERT T. BOND, EDWARD
21 W. BARNHOLT, STEPHEN P. KAUFMAN,
RICHARD J. ELKUS, JR., ARTHUR
22 SCHNITZER, GARY DICKERSON, STUART
NICHOLS and LEO CHAMBERLAIN,

23 Defendants,

24 – and –)

25 KLA-TENCOR CORPORATION, a Delaware
corporation,

26 Nominal Defendant.)

AMENDED CONSOLIDATED VERIFIED
SHAREHOLDER DERIVATIVE
COMPLAINT FOR VIOLATION OF THE
FEDERAL SECURITIES LAWS AND
STATE LAW CLAIMS FOR BREACH OF
FIDUCIARY DUTY, ABUSE OF
CONTROL, CONSTRUCTIVE FRAUD,
CORPORATE WASTE, UNJUST
ENRICHMENT, GROSS
MISMANAGEMENT, ACTION FOR
ACCOUNTING AND VIOLATION OF
CALIFORNIA CORPORATIONS CODE

27 DEMAND FOR JURY TRIAL
28

NATURE OF THE ACTION

1
2 1. This is a shareholder derivative action brought by Alaska Electrical Pension Fund, a
3 shareholder of KLA-Tencor Corporation ("KLA-Tencor" or the "Company"), on behalf of the
4 Company against its Board of Directors ("Board") and certain of its current and former senior
5 executives (collectively, "Defendants").¹ This action seeks to remedy Defendants' violations of
6 federal and state law, including breaches of fiduciary duty, abuse of control, constructive fraud,
7 corporate waste, unjust enrichment and gross mismanagement, arising out of a scheme and wrongful
8 course of business whereby Defendants allowed senior KLA-Tencor insiders to divert hundreds of
9 millions of dollars of corporate assets to themselves via the manipulation of grant dates associated
10 with hundreds of thousands of stock options granted to KLA-Tencor insiders. During the period
11 between 1995 and the present (the "Relevant Period"), each of the Defendants also participated in
12 the concealment of the option backdating scheme complained of herein and/or refused to take
13 advantage of the Company's legal rights to require these senior insiders to disgorge the hundreds of
14 millions of dollars in illicitly obtained incentive compensation and proceeds diverted to them since
15 1995.

16 2. During the Relevant Period, Defendants also caused KLA-Tencor to issue and file
17 false and misleading statements with the Securities and Exchange Commission ("SEC"), including
18 Proxy Statements filed with the SEC.

19 3. The action seeks to remedy Defendants' violations of federal and California state law,
20 including the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), §10(b) of the Securities Exchange
21 Act of 1934 ("Exchange Act") and Rule 10b-5 promulgated therein and §14(a) of the Exchange Act,
22 Cal. Corp. Code §§25402 and 25502.5, as well as breaches of fiduciary duties, abuse of control,
23

24 ¹ The "Individual Defendants" are Kenneth Levy ("Levy"), Kenneth L. Schroeder
25 ("Schroeder"), Richard P. Wallace ("Wallace"), John H. Kispert ("Kispert"), Jeffrey L. Hall
26 ("Hall"), Jon D. Tompkins ("Tompkins"), Lida Urbanek ("Urbanek"), H. Raymond Bingham
27 ("Bingham"), Robert J. Boehlke ("Boehlke"), Robert T. Bond ("Bond"), Edward W. Barnholt
28 ("Barnholt"), Stephen P. Kaufman ("Kaufman"), Richard J. Elkus, Jr. ("Elkus"), Arthur Schnitzer
("Schnitzer"), Gary Dickerson ("Dickerson"), Stuart Nichols ("Nichols") and Leo Chamberlain
("Chamberlain").

1 gross mismanagement, constructive fraud, waste of corporate assets, and unjust enrichment between
2 1995 and the present.

3 4. Plaintiffs demand an accounting of all stock option grants made to Defendants during
4 times relevant hereto, the rescission of all contracts which provide for stock option grants between
5 any of the Defendants and KLA-Tencor, which were entered into during times relevant hereto, and a
6 declaration that the illicit stock options, and all proceeds derived from exercise thereof, are and have
7 been held in constructive trust for the Company's benefit.

8 5. During the Relevant Period, the Company's executives and its non-employee
9 directors were compensated in large part through the issuance of stock options. A stock option
10 granted to an employee and/or director of a corporation allows the employee and/or director to
11 purchase company stock at a specified price – referred to as the “exercise price,” typically the fair
12 market value of the stock on the date the option is granted. When properly issued, stock options
13 serve as a valuable part of employee and/or director compensation packages as a means to create
14 incentives to boost profitability and stock value. When the employee and/or director exercises the
15 option, he or she purchases the stock from the company at the exercise price, regardless of the
16 stock's price at the time the option is exercised.

17 6. Dating back to at least 1996, the Defendants engaged in a scheme and course of
18 conduct designed to manipulate KLA-Tencor stock option grant dates so as to secretly maximize
19 profits to themselves and other Company executives at the expense of the Company and its
20 shareholders. Specifically, the Defendants, the Board and senior officers at the Company approved
21 the granting of backdated/misdated stock options in abdication of their fiduciary duties.

22 7. “Backdating”² is a practice by which a stock option is reported as having been
23 granted on one date, but is actually backdated weeks or months to a date where the stock price was
24 trading at a lower price. Such backdating allows company executives and stock option grantees to

25
26 ² Plaintiffs' use of the terms “backdating,” “misdating,” “backdated” and “misdated”
27 throughout this Complaint may also refer to other forms of related stock option manipulation
28 perpetrated by Defendants alleged in this action.

1 realize immediate unearned and undisclosed financial gains at the expense of the company's
2 shareholders. Backdating of stock option grants has been compared to picking lottery numbers on
3 the day after the winning numbers are announced, or betting on a horse after the race has finished.
4 Arthur Levitt, a former chairman of the SEC was quoted as stating that stock option backdating
5 "represents the ultimate in greed." Further, Levitt stated, "It is stealing, in effect. It is ripping off
6 shareholders in an unconscionable way." On May 5, 2006, President George W. Bush stated in an
7 interview on the Kudlow & Company show airing on CNBC that "overcompensating or trying to
8 backdate things is bad for America, and there ought to be consequences when people don't tell the
9 truth and are not transparent."

10 8. In addition, former SEC Chairman Harvey Pitt recently opined that the backdating of
11 stock options often involves the falsification of documents for personal gain:

12 Many discussions of backdating options start with the observation that backdating is
13 not, per se, illegal. That is wrong. ***Options backdating frequently involves***
14 ***falsification of records used to gain access to corporate assets. That conduct***
15 ***violates the Foreign Corrupt Practices Act and its internal controls requirements.***
If corporate directors were complicit in these efforts, state law fiduciary obligations
are violated. Backdating is not only illegal and unethical, it points to a lack of
integrity in a company's internal controls.

16 9. Furthermore, backdating stock options creates an instant paper gain to grantees who
17 receive them because the options were priced below the stock's fair market value when they were
18 actually awarded. Under Generally Accepted Accounting Principles ("GAAP"), this instant paper
19 gain is equivalent to paying extra compensation and thus is a cost to KLA-Tencor. Accordingly,
20 KLA-Tencor was required to record an expense to its financial statements for any options granted
21 below the fair market value on the grant date of the option, or "in the money" options. However, the
22 Defendants did not properly record these known costs on KLA-Tencor's financial statements,
23 causing KLA-Tencor's financial statements throughout the Relevant Period to be issued in violation
24 of GAAP. Specifically, these financial statements overstated reported earnings and understated
25 reported expenses.

26 10. In addition to Defendants' clear breach of fiduciary duty and violation of accounting
27 rules, Defendants' backdating of stock options may have extremely serious tax consequences for the
28 Company. While stock options generally qualify for favorable tax treatment, options issued at a

1 discount to the market price do not qualify for that treatment. Accordingly, backdated stock options
2 are automatically disqualified from that favorable tax relief, and KLA-Tencor has now
3 acknowledged that it may owe millions of dollars in unpaid taxes.

4 11. Defendants' conduct has already had severe consequences on the Company's
5 available assets and the credibility of its Board and executive leadership. The disruption to the
6 Company's business is and will continue to be immeasurable until the ongoing regulatory
7 investigations are complete, and the Company restates its many false and misleading financial
8 statements. Further, the Company is now the target of investigations by the SEC and the Department
9 of Justice ("DOJ") and is exposed to severe civil and criminal liability, including Internal Revenue
10 Service ("IRS") fines and back taxes.

11 12. Apart from the knowing issuance of false and misleading representations in financial
12 reports, Defendants misrepresented facts presented in Form 14-A Proxy Statements soliciting action
13 by Company shareholders, and in press releases and documents filed with the SEC, specifically
14 quarterly and year-end reports.

15 13. For example, throughout the Relevant Period, the Company described the purpose
16 and philosophy of the stock option and incentive program as necessary to align the long term
17 interests of executives with the that of the stockholders:

18 The goals of the Company's compensation policy are to attract, retain and reward
19 executive officers who contribute to the overall success of the Company by offering
20 compensation that is competitive in the industry, to motivate executives to achieve
21 the Company's business objectives and to align the interests of officers with the long
22 term interests of stockholders. The Company currently uses salary, a management
23 incentive plan, and stock options to meet these goals.

24 14. The Company also repeatedly and falsely represented that because stock options were
25 granted at market price on the date of the grant or fair market value on the date of the stock option
26 grants, the options only became valuable as the share price increased from the price on the date of
27 the grant:
28

1 *Stock options are granted at market price on the date of grant and will provide*
2 *value to the executive officers only when the price of the Company's Common*
3 *Stock increases over the exercise price.*³

4 15. During the Relevant Period, Defendants also caused the Company to falsely state that
5 it properly accounted for stock option issuance in accordance with Accounting Principles Board
6 ("APB") Opinion No. 25 as follows:

7 Stock-Based Compensation Plans

8 *The Company accounts for its stock option plans and employee stock purchase*
9 *plan in accordance with provisions of the Accounting Principles Board's Opinion*
10 *No. 25 (APB OPINION NO. 25), "Accounting for Stock Issued to Employees."*
11 *The Company's policy is to grant options at the fair market value on the date of*
12 *grant. Accordingly no compensation expense has been recorded.*

13 16. Defendants also assured shareholders that the issuance of stock options and their
14 exercise would be in compliance with all applicable federal, state and foreign law with respect to the
15 securities at issue:

16 COMPLIANCE WITH SECURITIES LAW. The grant of Options and the issuance
17 of shares of Stock upon exercise of Options shall be subject to compliance with all
18 applicable requirements of federal, state or foreign law with respect to such
19 securities.

20 17. At the same time that Defendants knowingly caused the Company to make these false
21 and misleading statements, Defendants knew but failed to disclose that the practices employed by the
22 Board allowed the stock option grants to be manipulated or *backdated* to dates when the Company's
23 shares were trading at or near the lowest price for that Relevant Period. By May 2006, Defendants'
24 backdating scheme had yielded stock option grants to the Company's executive officers worth
25 millions of dollars.

26 18. In order to conceal the falsity of the Company's financial statements, representations
27 of the adequacy of its internal controls, and the fraudulent issuance and manipulation of the
28 Company's stock option grants, Defendants, through key executives and the Board's Compensation

³ During the Relevant Period the Company issued stock options under several different stock option plans, including the 1982 Stock Option Plan, the 1990 Stock Option Plan, the 1993 Employee Incentive Stock Option Plan, the 1998 Outside Director Stock Option Plan, the 2004 Equity Incentive Plan and the 2000 Non-Statutory Plan (hereinafter "Stock Option Plans").

1 and Audit Committees, falsely assured shareholders that financial statements and associated
2 representations were accurate. Indeed, during the Relevant Period, Defendants Schroeder and
3 Kispert each claimed that they had investigated and reviewed the Company's financial statements
4 and internal control processes and authorized their inclusion in the Company's public filings.
5 Between 2002 and 2005, both Schroeder and Kispert signed false certifications pursuant to
6 Sarbanes-Oxley §§302 and 906. For example, Schroeder's Sarbanes-Oxley certification filed with
7 the Company's 2004 Form 10-K affirms:

8 I, Kenneth L. Schroeder certify that:

9 1. I have reviewed this annual report on Form 10-K of KLA-Tencor
10 Corporation;

11 2. Based on my knowledge, *this report does not contain any untrue statement*
12 *of a material fact or omit to state a material fact necessary to make the statements*
13 *made, in light of the circumstances under which such statements were made, not*
14 *misleading with respect to the period covered by this report;*

15 3. *Based on my knowledge, the financial statements*, and other financial
16 information included in this report, *fairly present in all material respects the*
17 *financial condition, results of operations* and cash flows of the registrant as of, and
18 for, the periods presented in this report;

19 4. *The registrant's other certifying officer and I are responsible for*
20 *establishing and maintaining disclosure controls and procedures (as defined in*
21 *Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:*

22 a. *designed such disclosure controls and procedures, or caused*
23 *such disclosure controls and procedures to be designed under our*
24 *supervision, to ensure that material information relating to the*
25 *registrant, including its consolidated subsidiaries, is made known to*
26 *us by others within those entities, particularly during the period in*
27 *which this report is being prepared;*

28 b. evaluated the effectiveness of the registrant's disclosure
controls and procedures and presented in this report our conclusions
about the effectiveness of the disclosure controls and procedures, as
of the end of the period covered by this report based on such
evaluation; and

c. disclosed in this report any change in the registrant's internal
control over financial reporting that occurred during the registrant's
most recent fiscal quarter (the registrant's fourth fiscal quarter in the
case of an annual report) that has materially affected, or is reasonably
likely to materially affect, the registrant's internal control over the
financial reporting; and

5. *The registrant's other certifying officer and I have disclosed, based on our*
most recent evaluation of internal control over financial reporting, to the

1 *registrant's auditors and the audit committee* of the registrant's board of directors
2 (or persons performing the equivalent functions):

- 3 a. all significant deficiencies and material weaknesses in the
4 design or operation of internal control over financial reporting which
5 are reasonably likely to adversely affect the registrant's ability to
6 record, process, summarize and report financial information; and
- 7 b. any fraud, whether or not material, that involves management
8 or other employees who have a significant role in the registrant's
9 internal control over financial reporting.

10 19. In fact, however, Defendants knew and failed to disclose that for years, the Company,
11 its senior executives and members of the Board, had been engaging in a continuing scheme and
12 course of conduct of backdating or misdating stock option grants to themselves and other executives
13 in a manner designed to create immediate and risk free profits in direct contravention of the
14 Company's stated and shareholder approved stock option plans and Proxy Statements.

15 20. Furthermore, Defendants knew that because the Company had not taken a
16 compensation expense for backdated options required by APB Opinion No. 25, KLA-Tencor
17 reported earnings and expenses were false and misleading and not in compliance with GAAP. Thus,
18 by falsifying the date on which options were granted, Defendants materially understated KLA-
19 Tencor expenses, overstated its income and falsely represented that it had not incurred any expenses
20 for option grants.

21 21. Defendants' misrepresentations and wrongful course of conduct violated the
22 Exchange Act, as well as California and Delaware law. By authorizing and/or acquiescing in the
23 stock option backdating scheme, Defendants: (a) caused KLA-Tencor to issue false statements; (b)
24 diverted hundreds of millions of dollars of corporate assets to themselves and KLA-Tencor
25 executives; and (c) subjected KLA-Tencor to liability from regulators including the SEC, the IRS
26 and federal prosecutors.

27 22. Throughout the Relevant Period, however, Defendants knew but failed to disclose
28 that stock option grants had been manipulated in order to create secret and risk-free profits to grant
29 recipients, and that as a result, the Company repeatedly and materially overstated its net income and
30 understated its expenses.

23. Further, throughout the Relevant Period, Defendants knowingly and falsely assured shareholders that in addition to the certified internal controls, the Board had Compensation, Audit, and Nominating and Governance Committees in place to oversee the Company's compensation practices including stock option issuances, accounting practices and overall corporate governance policies.

Compensation Committee

24. During the Relevant Period, the Company made the following representations regarding the responsibilities of the Compensation Committee of the Board:

Compensation Committee

The Committee is comprised of three of the *independent*, non-employee members of the Board of Directors, none of whom have interlocking relationships as defined by the Securities and Exchange Commission. The Committee is responsible for setting and administering the policies governing annual compensation of executive officers, considers their performance and *makes recommendations regarding their cash compensation and stock options to the full Board of Directors*. The Committee periodically reviews its approach to executive compensation and makes changes as appropriate.

Audit Committee

25. During the Relevant Period, Defendants gave assurances with regard to the Audit Committee's practices in evaluating the Company's financial statements and that its outside auditors did a comprehensive review of the Company's audit practices before authorizing them to be included in public financial statements. For example, set forth below is the Company's September 25, 2002 Audit Committee Report:

During fiscal year 2002, the Audit Committee met with the senior members of the Company's financial management team, the Company's independent auditors and the Company's General Counsel when appropriate. The Audit Committee also met separately with the Company's independent auditors and separately with the Company's Chief Financial Officer. The parties candidly discussed financial management, accounting and internal controls.

* * *

The Audit Committee reviewed and discussed the audited financial statements included in the Company's Annual Report with the Companies management including, without limitation, a discussion of the quality and not just the acceptability of the accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the financial statements as well as in Management's Discussion and Analysis of Results of Operations and Financial Condition. . . .

* * *

Based on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors, and the Board of Directors approved, the audited financial statements included in the Company's Annual Report for the fiscal year ended June 30, 2002, filed with the Securities and Exchange Commission on September 20, 2002.

26. The following chart illustrates the Board committee memberships between 1998-2005:

Members of the Committees of the Board of Directors

Year	Compensation	Audit	Nominating and Governance
1998	James Bagley Leo Chamberlain Lida Urbanek	Dean Morton Dag Tellefsen Samuel Rubinovitz	Edward Barnholt Kenneth Levy Jon Tompkins
1999	James Bagley Leo Chamberlain Lida Urbanek	Richard Elkus, Jr. Samuel Rubinovitz Dag Tellefsen	Edward Barnholt Kenneth Levy Dean Morton
2000	Edward Barnholt Robert Bond Lida Urbanek	Dean Morton Richard Elkus, Jr. Leo Chamberlain	Dean Morton Kenneth Levy Kenneth Schroeder Edward Barnholt
2001	Edward Barnholt Robert Bond Lida Urbanek	Raymond Bingham Richard Elkus, Jr. Dean Morton	Dean Morton Kenneth Levy Kenneth Schroeder Edward Barnholt
2002	Edward Barnholt Robert Bond Lida Urbanek	Raymond Bingham Richard Elkus, Jr. Dean Morton	Edward Barnholt Kenneth Levy Kenneth Schroeder
2003	Edward Barnholt Robert Bond Lida Urbanek	Raymond Bingham Robert Bond Richard Elkus, Jr. Stephen Kaufman	Edward Barnholt Richard Elkus
2004	Edward Barnholt Robert Bond Michael Marks Lida Urbanek	Raymond Bingham Robert Bond Richard Elkus, Jr. Stephen Kaufman	Edward Barnholt Kenneth Levy Kenneth Schroeder
2005	Edward Barnholt Robert Bond Michael Marks Lida Urbanek	Raymond Bingham Robert Bond Richard Elkus, Jr. Stephen Kaufman	Edward Barnholt Richard Elkus Stephen Kaufman

27. Finally, at the same time that Defendants were secretly issuing themselves and other KLA-Tencor executives backdated stock options and falsifying the Company's financial statements,

the Insider Selling Defendants unloaded millions of shares of KLA-Tencor stock for a total of more than **\$246 million** in insider trading proceeds:⁴

DEFENDANT	DATES OF SALES	SHARES SOLD	PROCEEDS RECEIVED
BARNHOLT	12/10/04 – 11/18/05	29,000	\$1,432,675
BINGHAM	11/22/05	5,000	\$263,100
BOEHLKE	8/1/97-3/3/00	352,400	\$14,136,330
BOND	09/13/05	5,000	\$253,050
CHAMBERLAIN	12/14/95 – 1/18/00	81,764	\$4,839,107
ELKUS	8/6/99 – 11/29/05	155,416	\$7,022,474
HALL	12/03/04 – 11/18/05	12,300	\$607,060
KISPERT	01/18/00 – 09/15/05	341,500	\$20,156,845
LEVY	04/30/96 – 02/27/06	2,285,651	\$111,476,225
NICHOLS	4/24/01 – 4/30/02	21,614	\$1,155,276
SCHROEDER	05/08/97 – 02/08/06	1,249,800	\$64,336,289
SCHNITZER	5/28/97-3/10/00	471,644	\$26,807,656
TOMPKINS	07/31/97 – 08/29/05	670,049	\$31,565,583
URBANEK	12/14/01 – 02/27/06	9,149	\$448,324
WALLACE	08/05/99 – 12/03/03	292,499	\$15,547,430
TOTAL		5,003,326	\$259,103,438

Illegal Backdating Forces KLA-Tencor to Restate Years of Financial Statements

28. On May 16, 2006, the Center for Financial Research and Analysis issued a report: “Options Backdating – Which Companies Are at Risk?” The report also identified the risks for companies that have taken part in options backdating:

- SEC investigation risk – The SEC has begun informal investigations at many companies in recent months and has also begun to call for improved disclosure around all areas of executive compensation.
- Accounting restatement risk – Some companies which have admitted backdating options have accompanied those admissions with financial restatements impacting both the balance sheet and earnings.
- Tax/Cash implications – The change in options from the practice of options backdating may force some companies to restate tax positions for the years in question, which could result in an obligation to pay back taxes.
- Management credibility risk – If a reputable management team is found to have repeatedly backdated options, thereby enriching themselves at the expense of shareholders, the reputation of management (and the related stock premium for superior management) could take a hit.

⁴ The “Insider Selling Defendants” are Barnholt, Bingham, Boehlke, Bond, Chamberlain, Elkus, Hall, Kispert, Levy, Nichols, Schroeder, Schnitzer, Tompkins, Urbanek, and Wallace.

1 29. On May 22, 2006, *The Wall Street Journal* reported that KLA-Tencor had shown
2 questionable patterns surrounding the timing of option grants to its executives. Later the same day,
3 it was disclosed that U.S. federal prosecutors were investigating executive stock option grants at
4 KLA-Tencor. These disclosures caused KLA-Tencor's stock to close down \$4.70 per share on
5 extremely high volume at \$40.54 on May 22, 2006 – a one day decline of 10.4%.

6 30. On May 24, 2006, the Company announced that it had received subpoenas from the
7 United States Attorneys' Offices in New York and California. In addition, the Company had formed
8 a Special Committee of "independent" directors to investigate the timing of stock option grants
9 between 1995-2001:

10 **KLA-Tencor Announces Formation of Special Committee to Investigate Stock**
11 **Option Practices**

12 SAN JOSE, Calif., May 24, 2006 – KLA/Tencor Corporation (NASDAQ: KLAC)
13 today announced that its Board of Directors has appointed a special committee of
14 independent directors to conduct an internal investigation relating to past stock
options granted to employees during the 1995 to 2001 timeframe. The special
committee is investigating the timing of such grants and related accounting and
documentation and will be assisted by outside legal counsel and accounting experts.

15 KLA-Tencor also said that it has received subpoenas from the U.S. Attorney's
16 Offices for the Eastern District of New York and Northern District of California
requesting information related to its past stock option grants. . . .

17 31. As a result of the sharp decline in KLA-Tencor's stock price due to its involvement in
18 the ongoing option granting scandal, KLA-Tencor was forced to renegotiate its deal to acquire ADE
19 Corporation ("ADE"). On May 26, 2006, the Company announced that it had amended a merger
20 agreement it had previously entered into with ADE to acquire ADE in a stock-for-stock transaction
21 valued at approximately \$488 million. Under the agreement, KLA-Tencor would issue 0.64 share of
22 KLA-Tencor per one share of ADE. This calculation was based upon the closing price of KLA-
23 Tencor stock for February 22, 2006 of \$51.73. Due to the sharp decline in the value of KLA-
24 Tencor's stock, KLA-Tencor was forced to change the terms of its agreement with ADE into an all-
25 cash transaction instead of a stock-for-stock transaction. On May 26, 2006, KLA-Tencor announced
26 that it had amended its agreement with ADE from a stock-for-stock transaction to an all-cash
27 transaction and that it had agreed to pay \$32.50 *in cash* per share of ADE stock. KLA-Tencor's
28 stock closed at \$40.62 per share on May 26, 2006 – a 21.5% decline from February 22, 2006.

1 32. On May 30, 2006, KLA-Tencor announced that it received notice from the SEC of an
2 informal inquiry relating to past stock option grants.

3 33. On June 30, 2006, KLA-Tencor issued a press release to report the preliminary
4 conclusion of its Special Committee with respect to its ongoing internal investigation relating to past
5 stock option grants, the timing of such grants and related accounting and documentation. The
6 preliminary report found that the measurement date for certain option grants indeed likely differed
7 from the recorded date of the grants. The Company further indicated that it would likely have to
8 restate its financials to correct improperly reported compensation expenses.

9 *[A] Special Committee of the Company's Board of Directors has reached a*
10 *preliminary conclusion that the actual measurement dates for financial accounting*
11 *purposes of certain stock option grants issued in prior years likely differ* from the
12 recorded grant dates of such awards. The Special Committee has not completed its
investigation and is continuing its review of these matters. The Special Committee
has not yet determined whether any resulting compensation charges are material or
whether the Company ultimately will restate previously issued financial statements.

13 The Company previously announced that its Board of Directors has appointed a
14 Special Committee of independent directors to conduct an internal investigation
15 relating to stock options granted to members of senior management and the
16 employees of the Company. The Special Committee, assisted by independent legal
counsel and accounting experts, is investigating the timing of such grants, as well as
their related accounting treatment.

17 *Based on the Special Committees investigation to date, the Company now*
18 *anticipates that it may record additional non-cash charges for stock-based*
19 *compensation expense.* The Company has not yet determined the amount of such
charges or the resulting tax impact of these actions. *In the event that the Company*
determines that these items are material, KLA-Tencor may be required to restate its
financial statements for the relevant prior fiscal periods.

20 34. On July 27, 2006, KLA-Tencor issued a press release announcing that as a result of
21 the on-going internal investigation relating to stock option grants previously disclosed on May 24,
22 2006, the Company would be unable to provide detailed GAAP financials for items other than
23 revenue and bookings for the quarter or year ended June 30, 2006. The Company also disclosed that
24 it would not file its annual report on Form 10-K.

25 35. On September 14, 2006, the Company announced that it received a NASDAQ Staff
26 Determination notice indicating that the Company is not in compliance with the filing requirements
27 for continued listing as set forth in NASDAQ Marketplace Rule 4310(c)(14) and that its common
28 stock is subject to delisting from the NASDAQ Global Select Market:

KLA-Tencor Delays Filing Form 10-K and Receives Notice from Nasdaq

* * *

As a result of the delayed filing of the Company's Form 10-K, the Company today received a NASDAQ Staff Determination notice indicating that the Company is not in compliance with the filing requirements for continued listing as set forth in NASDAQ Marketplace Rule 4310(c)(14) and that its common stock is subject to delisting from the NASDAQ Global Select Market. . . .

36. On September 28, 2006, the Company issued a press release stating that it would restate publicly reported financial statements due to the backdating/misdating of stock options and that all of its financial statements issued since July 1997 should no longer be relied upon. Moreover, the Company stated that its restatement could reduce previously reported net income and increase previously reported losses during the Relevant Period:

KLA-Tencor Will Restate Financial Statements Related to Stock Options

SAN JOSE, Calif., September 28, 2006 -- KLA-Tencor Corporation (NASDAQ: KLAC) today announced that it will restate previously issued financial statements to correct the Company's past accounting for stock options. Based on a report received from a Special Committee of the Board of Directors, the Board concluded that incorrect measurement dates for certain stock option grants were used for financial accounting purposes, principally during the periods July 1, 1997 through June 30, 2002. As a result, the Company will be required to record non-cash charges for compensation expenses relating to those past stock option grants.

The Company has not determined the exact amount of such charges, the resulting tax and accounting impact, or which specific reporting periods may require restatement. Accordingly, the Company is filing a Form 8-K today stating that the financial statements and all earnings and press releases and similar communications issued by the Company relating to periods beginning on or after July 1, 1997, should no longer be relied upon. KLA-Tencor intends to file its restated financial results and Annual Report on Form 10-K as quickly as practicable.

KLA-Tencor does not anticipate that the restatement will have any impact on the Company's historical revenues. Any stock-based compensation charges incurred as a result of the restatement would have the effect of decreasing reported income or increasing reported loss from operations, and decreasing reported net income or increasing reported net loss, and decreasing reported retained earnings amounts contained in the Company's historical financial statements for the affected periods.

37. On October 3, 2006, the Company filed a Form 8-K with the SEC further detailing the findings of the Special Committee and specifically stating that the measurement dates and the grant dates for stock options issued during the Relevant Period materially differed and the Company would indeed restate seven years of financial statements:

1 A Special Committee of the Board of Directors of KLA-Tencor Corporation (the
2 "Company") has delivered a report to the Board of Directors, which concluded that
3 incorrect measurement dates were used for certain stock option grants made
4 principally during the period from July 1, 1997 through July 30, 2002. The Board of
5 Directors of the Company has not concluded its evaluation of the factors that led to
6 the use of incorrect measurement dates of stock options. The Board of Directors has
7 concluded that the Company will need to restate certain of its historical financial
8 statements to record non-cash charges for compensation expenses relating to past
9 stock option grants. *The Company has not determined the amount of such charges,*
10 *the resulting tax and accounting impacts, the impact on internal control over*
11 *financial reporting, or which specific periods may require restatement. However,*
12 *the effects on previously reported financial statements are expected to be material.*
13 The Special Committee and the Board of Directors will continue to be actively
14 involved in reviewing information and determining the appropriate actions to be
15 taken by the Company with respect to this matter.

16 *Accordingly, on September 27, 2006, the Board of Directors concluded that*
17 *financial statements and all earnings and press releases and similar*
18 *communications issued by the Company relating to periods beginning on or after*
19 *July 1, 1997, should no longer be relied upon, including the Company's financial*
20 *statements for fiscal years 1998 through 2005, the interim periods contained*
21 *therein, and the fiscal quarters ended September 30, 2005, December 31, 2005 and*
22 *March 31, 2006. The Company's management and the Special Committee have*
23 *discussed this matter with PricewaterhouseCoopers LLP, the Company's*
24 *independent registered public accounting firm.*

25 38. The same Form 8-K stated that the Company had taken steps to restrict or freeze the
26 exercise and sale of any stock options during the period that the investigation was ongoing and
27 imposing a "blackout" period on the acquisition of any shares under the stock option plans.

28 On September 27, 2006, KLA-Tencor Corporation (the "Company") determined that
its historical financial statements for one or more prior fiscal years will have to be
restated as a result of improper accounting for option grants made to officers and
employees. *The specific fiscal years which will need to be restated has yet been*
determined. However, the Company has decided to suspend temporarily employee
participation in several equity incentive programs because the S-8 registration
statements covering the shares of common stock issuable under those programs
incorporate one or more financial statements that will likely have to be restated. As
part of such suspension, participants in the Company's 401(k) Plan (the "401(k)
Plan") will be subject to a blackout period during which they will be precluded from
acquiring shares of the Company's common stock under that plan.

39. On October 16, 2006, the Company announced that the Special Committee's
investigation had concluded that the Company would have to restate a *whopping \$400 million in*
compensation expense. Moreover, the Company specifically implicated defendant Schroeder in the
scheme, terminating all relationships with Schroeder immediately. Schroeder had been the
Company's President and Chief Operating Officer ("COO"), Chief Executive Officer ("CEO") and a
member of the Board between 1995-2005. The Company also fired its General Counsel, defendant

1 Nichols. In addition, the Company canceled all backdated stock options held by defendant
2 Schroeder and repriced options held by Nichols:

3 **KLA-Tencor Announces Results of Special Committee Investigation of**
4 **Historical Stock Option Practices**

5 Stock-Based Compensation Expenses Not Expected to Exceed \$400 Million

6 SAN JOSE, California, October 16, 2006 KLA -- Tencor Corporation (NASDAQ:
7 KLAC) today announced that the Special Committee investigation of the Company's
8 historical stock option practices has been substantially completed. As previously
9 announced, the Company's Board of Directors concluded that incorrect measurement
10 dates for certain stock option grants were used for financial accounting purposes,
principally during the period July 1, 1997 through June 30, 2002, and as a result, the
Company will restate its financial statements to correct the accounting for
retroactively priced stock options. *The Company now anticipates that the total
additional non-cash charges for stock-based compensation expenses will not
exceed \$400 million.*

11 *As a result of the investigation, the Company has terminated all aspects of its*
12 *employment relationship with Kenneth L. Schroeder, effective immediately.*
13 *Mr. Schroeder was President and Chief Operating Officer of the Company from*
1991 to 1999 and Chief Executive Officer and a member of the Board of Directors
from 1999 through 2005.

14 *The Company also announced that its General Counsel, Stuart J. Nichols, has*
15 *resigned, effective immediately. Mr. Nichols had been Vice President and General*
Counsel of the Company since 2000. . . .

16 *The Company further announced its intention to cancel all outstanding*
17 *retroactively priced stock options held by Mr. Schroeder and to re-price all*
18 *outstanding retroactively priced stock options held by Mr. Nichols. The exercise*
price of each re-priced option will be increased to the fair market value on the
corrected measurement date.

19 40. The Company also indicated that it had found no wrongdoing by current members of
20 management (though Levy simultaneously "retired"), but repriced options held by Kispert because
21 he was the Chief Financial Officer ("CFO") during the Relevant Period and likely received
22 backdated stock options.

23 Based on the Special Committee's investigation, the Board of Directors concluded
24 that there was no involvement in the improper stock option practices by any current
25 members of Company management, including Richard P. Wallace, John H. Kispert
26 and Jeffrey L. Hall, who became Chief Executive Officer, Chief Operating Officer
27 and Chief Financial Officer, respectively, in early 2006. *Although the Board of*
Directors concluded that Mr. Kispert was not involved in the improper stock option
practices, based on the Special Committee's recommendation, his outstanding
retroactively priced options will be re-priced (in the manner described above)
because he served as Chief Financial Officer during part of the period in question.
While the Company is evaluating whether the factors that led to the restatement
constituted a material weakness as of June 30, 2006, *the Company believes that it*

1 *has in place the necessary internal controls to ensure proper accounting for stock*
2 *options going forward.*

3 The Special Committee will now concentrate its efforts on assisting the Company's
4 management with the restatement of the Company's affected financial statements.
5 The restatement process is well underway, and the Company will continue to work
6 diligently to determine the exact amount of additional non-cash charges for stock-
based compensation expenses, the resulting accounting and tax impact, and the
specific prior periods requiring restatement, and to file its Annual Report on Form
10-K for the fiscal year ended June 30, 2006, as well as other required reports, as
soon as practicable.

7 41. On October 17, 2006, the Company announced additional executive departures due to
8 the options backdating scandal, specifically, the Company's long-time Chairman of the Board and
9 founder, defendant Levy. The Company further admitted that defendant Levy also received
10 backdated stock options and that the Company would reprice stock options that he received as part
11 of the scheme:

12 **KLA-Tencor Announces Retirement of Board Chairman Kenneth Levy**

13 * * *

14 SAN JOSE, California, October 17, 2006 -- KLA-Tencor Corporation (NASDAQ:
15 KLAC) today announced that Kenneth Levy, Founder and Chairman of the Board,
has informed the Company that he is retiring as a Director and employee, effective
16 immediately. Mr. Levy was a member of the Board of Directors of the Company
since 1975, Chairman of the Board since 1999, and Chief Executive Officer from
1975 to 1997 and from mid 1998 to mid 1999.

17 * * *

18 *The Company separately announced results of the investigation by the Special*
19 *Committee of the Board of Directors of the Company's historical stock option*
20 *practices. Based upon that investigation, the Company intends to re-price all*
21 *outstanding retroactively priced options by Mr. Levy and certain other former and*
current executives of the Company. The exercise price of each re-priced option
will be increased to the fair market value on the corrected measurement date.

22 42. On November 15, 2006, the Company announced that it was still unable to file its
23 financial statements and had received yet another notice from NASDAQ of its non-compliance.

24 43. On January 29, 2007, the Company filed its form 10-K for the fiscal year ending
25 June 30, 2006 with the SEC. The form 10-K included restated financials statement covering 1994-
26 2006. In addition, the Company admitted that during the Special Committee's investigation they
27 indeed discovered that stock options had been retroactively priced for all employees who received
28 grants:

1 As a result of an investigation of our historical stock option practices by a Special
2 Committee of our Board of Directors . . . *we discovered that certain of our stock*
3 *options, primarily those granted from July 1, 1997 to June 30, 2002, had been*
4 *retroactively priced for all employees who received these grants (less than 15% of*
5 *these options were granted to executive officers). This means that the option*
6 *exercise price was not the market price of the option shares on the actual grant*
7 *date of the option, but instead was a lower market price on an earlier date.*

8 *The actual grant date—when the essential actions necessary to grant the option*
9 *were completed, including the final determination of the number of shares to be*
10 *granted to each employee and the exercise price—is the correct measurement date*
11 *to determine the market price of the option shares under the accounting rules in*
12 *effect at the time. More than 95% of the total in-the-money value (market price on*
13 *the actual grant date minus exercise price) of all of our retroactively priced options*
14 *was attributable to those granted from July 1, 1997 to June 30, 2002.*

15 44. In addition to admitting that option grants had been backdated during the Relevant
16 Period, the Company, in its January 29, 2007 form 10-K, admitted that the Company had failed to
17 properly apply APB Opinion No. 25 which requires that a compensation expense be taken for
18 options whose exercise price is lower than the market price on the date of the grant, thus requiring
19 restatement of \$348 million for the period of 1994-2005 compensation expense:

20 *Because each of our retroactively priced options had an exercise price below the*
21 *market price on the actual grant date, there should have been a charge for each of*
22 *these options under APB Opinion No. 25 equal to the number of option shares,*
23 *multiplied by the difference between the exercise price and the market price on the*
24 *actual grant date. That expense should have been amortized over the vesting period*
25 *of the option. Starting in our fiscal year ended June 30, 2006, we adopted SFAS*
26 *No. 123(R), "Share-Based Payment." As a result, for fiscal year 2006, the*
27 *additional stock-based compensation expense required to be recorded for each*
28 *retroactively priced option was equal to the incremental fair value of these options*
on the actual grant date over the remaining vesting period of the option. We did
not record these stock-based compensation expenses under APB Opinion No. 25 or
SFAS No. 123(R) related to our retroactively priced options in our previously
issued financial statements, and that is why we are restating them in this filing.

To correct our past accounting for stock options, we recorded additional pre-tax,
non-cash, stock-based compensation expense of (a) \$348 million for the periods
July 1, 1994 to June 30, 2005 under APB Opinion No. 25 and (b) \$22 million for
the year ended June 30, 2006 under SFAS No. 123(R). We expect to amortize an
additional \$6 million of such pre-tax charges under SFAS No. 123(R) in future
periods to properly account for past retroactively priced option grants.

45. The Company further detailed the Special Committee's findings, including its
findings that the retroactive price of stock options was intentional and involved the falsification of
Company records, and the 10-K revealed that "Management reviewed the findings of the Special
Committee and conducted its own internal review of our past stock option grants and other aspects

1 of our historical financial statements. Management agrees with the Special Committee” The
2 10K detailed their findings as follows:

3 *By October 16, 2006, the Special Committee had substantially completed its*
4 *investigation. The Special Committee concluded that*

5 *(1) there was retroactive pricing of stock options granted to all employees*
6 *who received options, primarily during the periods from July 1, 1997 to June 30,*
7 *2002 (less than 15% of these options were granted to executive officers),*

8 *(2) the retroactively priced options were not accounted for correctly in our*
9 *previously issued financial statements,*

10 *(3) the retroactive pricing of options was intentional, not inadvertent or*
11 *through administrative error,*

12 *(4) the retroactive pricing of options involved the selection of fortuitously*
13 *low exercise prices by certain former executive officers, and other former*
14 *executives may have been aware of this conduct,*

15 *(5) the retroactive pricing of options involved the falsification of Company*
16 *records, resulting in erroneous statements being made in financial and other*
17 *reports previously filed with the SEC, as well as in information previously provided*
18 *to our independent registered public accounting firm, and*

19 *(6) in most instances, the retroactive pricing of options violated the terms of*
20 *our stock option plans. Because virtually all holders of retroactively priced options*
21 *issued by the Company were not involved in or aware of the retroactive pricing, the*
22 *Board of Directors decided that we should continue to honor the options that*
23 *violated the terms of our stock option plans, except in certain individual cases as*
24 *described below.*

25 *The Special Committee concluded that, with a few immaterial exceptions, the*
26 *retroactive pricing of stock options stopped after June 30, 2002. After that time,*
27 *there were procedures in place designed to provide reasonable assurance that stock*
28 *options were priced on the grant date. The Special Committee also concluded that*
none of our independent Directors was involved in or aware of the retroactive
pricing of stock options. Based on the Special Committee’s report, our Board of
Directors concluded that no current members of management were involved in the
retroactive pricing of stock options. During its investigation of our historical stock
option practices, the Special Committee did not find evidence of any other financial
reporting or accounting issues.

46. With respect to certain individuals alleged herein to have either participated in the
issuance of or received backdated stock options, the Company made the following disclosures with
respect to Defendants Levy, Schroeder, Nichols, Kispert, Tomkins and Wallace. More specifically,
the Company cancelled all outstanding stock options to held by Schroeder and repriced stock options
that were issued to defendants Levy, Nichols, Tomkins, Wallace and Kispert:

1 Schroeder

2 *As a result of the Special Committee investigation, on October 16, 2006, we*
3 *terminated our employment relationship and agreement with Kenneth L.*
4 *Schroeder, and we announced our intent to cancel all outstanding stock options*
5 *held by Mr. Schroeder that were retroactively priced or otherwise improperly*
6 *granted. Those options [596, 740] were canceled in December 2006. . . .*

7 . . . Accordingly, in the second quarter of fiscal 2007 we will reverse approximately
8 \$20 million of the non-cash, stock-based compensation charge recorded in prior
9 periods. In December 2006, we canceled 596,740 vested option shares held by Mr.
10 Schroeder as of the time of termination, representing those shares that had been
11 retroactively priced or otherwise improperly granted.

12 Nichols

13 Also on October 16, 2006, Stuart J. Nichols, Vice President and General Counsel,
14 resigned. Mr. Nichols and we entered into a Separation Agreement and General
15 Release under which *Mr. Nichols' outstanding retroactively priced stock options*
16 *have been re-priced by increasing the exercise price to the market price of the*
17 *option shares on the actual grant date.*

18 Levy

19 On October 16, 2006, Kenneth Levy, Founder and Chairman of the Board of
20 Directors of the Company, retired as a director and employee, and was named
21 Chairman Emeritus by our Board of Directors. *Mr. Levy and we entered into a*
22 *Separation Agreement and General Release under which Mr. Levy's outstanding*
23 *retroactively priced stock options have been re-priced by increasing the exercise*
24 *price to the market price of the option shares on the actual grant date.*

25 Tompkins

26 On December 21, 2006, Jon D. Tompkins resigned as a director of the Company, and
27 we agreed to modify the outstanding options held by Mr. Tompkins (all of which
28 were fully vested) to extend the post-termination exercisability period to December
29 31, 2007, which is the last day of the calendar year in which those options would
30 have terminated in the absence of such extension. . . .

31 Kispert

32 Although the Board of Directors concluded that John H. Kispert, our President and
33 Chief Operating Officer, was not involved in and was not aware of the improper
34 stock option practices, *based on the Special Committee's recommendation, his*
35 *outstanding retroactively priced options have been re-priced because he served as*
36 *Chief Financial Officer during part of the period in question. This re-pricing*
37 *involved increasing the exercise price to the market price of the option shares on*
38 *the actual grant date.*

39 47. Finally, with respect to the some of the tax implications caused by the backdated
40 stock options and the Company's failure to properly account for them, the Company stated that it

1 will pay bonuses to defendant Wallace and to non officers to address adverse consequences of
2 backdated stock options:

3 Three of the Company's option holders were subject to the December 31, 2006
4 deadline described above. Accordingly, in December 2006, the Company offered to
5 amend the 409A Affected Options held by Mr. Wallace, the Company's Chief
6 Executive Officer, and two former executive officers to increase the exercise price so
7 that these options will not subject the option holder to a penalty tax under IRC
8 Section 409A. All three individuals accepted the Company's offer. In addition, the
9 Company agreed to pay each of the three individuals a cash bonus in January 2008
10 equal to the aggregate increase in the exercise prices for his amended options. For
11 Mr. Wallace, the amount of this bonus is \$0.4 million. The Company plans to take
12 similar actions with respect to the outstanding 409A Affected Options granted to
13 non-officers as soon as possible after the filing of this Report. The Company
14 estimates that the total cash payments needed to deal with the adverse tax
15 consequences of retroactively priced options granted to non-officers will be
16 approximately \$30 million.

17 With respect to the individuals whose options were canceled or re-priced by the
18 Company following the Special Committee investigation, no bonuses of the type
19 described above will be paid.

20 48. Defendants' gross mismanagement and malfeasance over the past decade has exposed
21 KLA-Tencor and its senior executives to criminal and civil liability for issuing false and misleading
22 financial statements. Specifically, Defendants caused or allowed KLA-Tencor to issue statements
23 that failed to disclose or misstated the following: (a) that the Company had material weaknesses its
24 internal controls that prevented it from issuing accurate financial reports and projections; (b) that
25 because of improperly recorded stock-based compensation expenses, the Company's financial results
26 violated GAAP; and (c) that the Company's public disclosures presented an inflated view of KLA-
27 Tencor's earnings and earnings per share ("EPS").

28 49. Defendants' malfeasance and mismanagement during the Relevant Period has
wreaked millions of dollars of damages on KLA-Tencor. The Company's senior executives were
incentivized to over-pay themselves, to profit from their misconduct by cashing in on under-priced
stock options and to issue false financial statements to cover up their misdeeds. Defendants' breach
of fiduciary duties in the administration of the Company's stock option plans so polluted the plans
with grant date manipulations as to void all grants made pursuant to the plans. Meanwhile, certain of
the Defendants, who received under-priced stock options and/or knew material non-public
information regarding KLA-Tencor's internal control problems, abused their fiduciary relationship

1 with the Company by selling over \$259 million worth of their personally held shares at artificially
2 inflated prices during the Relevant Period. This action seeks recovery for KLA-Tencor against these
3 faithless fiduciaries, as KLA-Tencor's Board, as currently composed, is simply unable or unwilling
4 to do so as more fully set in the Derivative Demand Futility Allegations, *infra*, ¶¶165-169.

5 50. At the time the first derivative action was commenced, the KLA-Tencor Board
6 consisted of nine directors: Levy, Barnholt, Wallace, Kaufman, Urbanek, Bond, Tompkins, David
7 Wang ("Wang") and Bingham. Eight of these directors are incapable of independently and
8 disinterestedly considering a demand to commence and vigorously prosecute the derivative actions:

9 (a) Defendants Levy, Tompkins and Wallace are incapable because they received
10 backdated stock options, and they are directly interested in the improperly backdated stock option
11 grants complained of herein, as recipients thereof. These defendants also sold hundreds of thousands
12 of shares of KLA-Tencor stock for millions of dollars in insider trading proceeds (*see supra*, ¶27);

13 (b) Bond, Barnholt and Urbanek are incapable because, as members of the
14 Compensation Committee, each directly participated in and approved the improper backdating of
15 stock options, as alleged herein, or misrepresented and falsely assured the Company shareholders
16 that KLA-Tencor stock options were issued at fair market value on the date of the grant. They
17 indeed were the Board members who purported but failed to "*review[] . . . the Company's executive*
18 *compensation policy and administer[] the Company's . . . equity benefit plan*" under which stock
19 options were granted. Moreover, by colluding with Defendants and others, as alleged herein, Bond,
20 Barnholt and Urbanek have demonstrated that they are unable and unwilling to act independently of
21 Defendants; and

22 (c) All of the members of the Audit Committee, including Bingham, Bond and
23 Kaufman, are incapable because as veteran members of the Audit Committee, they directly
24 participated in and approved the Company's knowing violations of GAAP and IRS Code §162(m),
25 as alleged herein. Defendant Bingham was represented to shareholders as being a "financial expert,"
26 and has been Chairman of the Audit Committee for the last five years. Moreover, by colluding with
27 Defendants and others, as alleged herein, Bingham, Bond and Kaufman have demonstrated that they
28 are unable and unwilling to act independently of Defendants.

INTRADISTRICT ASSIGNMENT

51. A substantial part of the events or omissions which give rise to the claims in this action occurred in the county of Santa Clara, and as such this action is properly assigned to the San Jose division of this Court.

JURISDICTION AND VENUE

52. The claims asserted herein arise under §§10(b), 14(a) and 20(a) of the Exchange Act, 15 U.S.C. §§78j(b), 78n(a) and 78t(a), and Rule 10b-5, 17 C.F.R. §240.10b-5, promulgated thereunder, and under California and Delaware law for violations of breach of fiduciary duty, abuse of control, constructive fraud, corporate waste, unjust enrichment and gross mismanagement. In connection with the acts, conduct and other wrongs complained of herein, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, the United States mail and the facilities of a national securities market.

53. This Court has subject matter jurisdiction pursuant to §27 of the Exchange Act, 15 U.S.C. §78aa, as well as 28 U.S.C. §§1331 and 1337. This Court also has supplemental jurisdiction over the state law claims asserted herein pursuant to 28 U.S.C. §1367.

54. This action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have.

55. Venue is proper in this district pursuant to §27 of the Exchange Act, 15 U.S.C. §78aa, as well as 28 U.S.C. §1391(b). Many of the acts charged herein, including the preparation and dissemination of materially false and misleading information, occurred in substantial part in this District. KLA-Tencor is located in and conducts its business in this District. Further, Defendants conduct business in this District, and are citizens of California and reside in this District.

PARTIES

56. Plaintiff Alaska Electrical Pension Fund is, and at times relevant hereto was, a shareholder of nominal party KLA-Tencor. During the Relevant Period, the Company had more than 500 shareholders of record.

57. Nominal party KLA-Tencor is a supplier of process control and yield management solutions for the semiconductor and related microelectronics industries. The Company's portfolio of

1 products, software, analysis, services and expertise is designed to help integrated circuit
2 manufacturers manage yield throughout the entire fabrication process, from research and
3 development to final mass-production yield analysis. The Company was founded in July 1975 as
4 KLA Instruments Corporation. In May 1997, KLA Instruments merged with Tencor Instruments –
5 another longtime leader in semiconductor industry – and changed its name to KLA-Tencor.

6 58. Defendant Levy has been Chairman of the Board of KLA-Tencor since July 1999.
7 Levy is the founder of KLA Instruments and at all times has served as a director of the Company.
8 Levy served as the CEO of KLA Instruments from its inception until its merger with Tencor
9 Instruments in May 1997. From July 1998 to June 1999, Levy served as CEO of KLA-Tencor. At
10 all relevant times, Levy actively participated in the management of KLA-Tencor's daily business
11 affairs and finances. He also actively participated in the preparation, review and approval of KLA-
12 Tencor's publicly reported financial results and financial statements for Fiscal Years ("FY")⁵ 1995-
13 2005, as well as the corresponding reports on SEC Form 10-K and press releases. By reason of his
14 executive positions with the Company, Board membership and ownership of KLA-Tencor stock,
15 Levy was a controlling person of KLA-Tencor and had the power and influence, and exercised the
16 same, to cause KLA-Tencor to engage in the conduct detailed with particularity herein. Based on his
17 knowledge of material non-public information regarding the Company, defendant Levy violated Cal.
18 Corp. Code §§25402 and 25502.5 by selling 2.28 million KLA-Tencor shares for insider trading
19 proceeds of more than \$111 million.

20 59. Defendant Schroeder was from 1991 to 1999 President and COO of the Company.
21 He was a CEO of the Company. During the Relevant Period, Schroeder was also a director of KLA-
22 Tencor from July 1, 1999, until he retired from the Company effective January 1, 2006. Schroeder
23 initially joined KLA Instruments in 1979 and left in 1987. Schroeder returned to KLA Instruments
24 in 1991. From November 1991 to July 2002 Schroeder held the position of President of the
25 Company. He again held the position of President from May 2004 to July 2005. At all relevant

26
27 ⁵ KLA-Tencor's fiscal year ends June 30. Accordingly, the Company's FY 1995 started
28 July 1, 1994 and ended June 30, 1995.

1 times, Schroeder actively participated in the management of KLA-Tencor's daily business affairs
2 and finances. He also actively participated in the preparation, review and approval of KLA-Tencor's
3 publicly reported financial results and financial statements for FY 1995-2005, as well as the
4 corresponding reports on SEC Form 10-K and press releases. By reason of his executive positions
5 with the Company, Board membership and ownership of KLA-Tencor stock, Schroeder was a
6 controlling person of KLA-Tencor and had the power and influence, and exercised the same, to
7 cause KLA-Tencor to engage in the conduct detailed with particularity herein. Based on his
8 knowledge of material non-public information regarding the Company, defendant Schroeder violated
9 Cal. Corp. Code §§25402 and 25502.5 by selling 1.25 million KLA-Tencor shares for insider trading
10 proceeds of more than \$64 million.

11 60. Defendant Wallace is the current CEO and a director of KLA-Tencor. Defendant
12 Wallace, during the Relevant Period and since 2000, was Executive Vice President ("EVP") of the
13 Company. He was appointed to his current position effective January 1, 2006. Wallace joined
14 KLA-Tencor in 1988 serving in a variety of senior management positions – most recently serving as
15 President and COO from July 2005 to January 2006. Wallace also actively participated in the
16 preparation, review and approval of KLA-Tencor's publicly reported financial results and financial
17 statements for FY 1995-2005, as well as the corresponding reports on SEC Form 10-K and press
18 releases. By reason of his executive positions with KLA-Tencor, Board membership and ownership
19 of KLA-Tencor stock, Wallace was a controlling person of KLA-Tencor and had the power and
20 influence, and exercised the same, to cause KLA-Tencor to engage in the conduct detailed with
21 particularity herein. Based on his knowledge of material non-public information regarding the
22 Company, defendant Wallace violated Cal. Corp. Code §§25402 and 25502.5 by selling 292,499
23 KLA-Tencor shares for insider trading proceeds of more than \$15.5 million during the Relevant
24 Period.

25 61. Defendant Kispert is the current President and COO of KLA-Tencor. He was
26 appointed to his current position effective January 1, 2006. Previously, Kispert served as CFO of
27 KLA-Tencor from July 2000 until his promotion to President and COO. Kispert joined KLA-Tencor
28 in 1995 serving in a variety of senior management positions. Kispert actively participated in the

1 preparation, review and approval of KLA-Tencor's publicly reported financial results and financial
2 statements for FY 1995-2005, as well as the corresponding reports on SEC Form 10-K and press
3 releases. By reason of his executive positions at the Company and ownership of KLA-Tencor stock,
4 Kispert was a controlling person of KLA-Tencor and had the power and influence, and exercised the
5 same, to cause KLA-Tencor to engage in the conduct detailed with particularity herein. Based on his
6 knowledge of material non-public information regarding the Company, defendant Kispert violated
7 Cal. Corp. Code §§25402 and 25502.5 by selling 341,500 KLA-Tencor shares for insider trading
8 proceeds of more than \$20.1 million during the Relevant Period.

9 62. Defendant Hall is the CFO of KLA-Tencor. He was appointed to his current position
10 effective January 1, 2006. Hall joined the Company in 2000 acting as the Vice President ("VP") of
11 Finance, Mergers and Acquisitions. During the Relevant Period, Hall actively participated in the
12 preparation, review and approval of KLA-Tencor's publicly reported financial results and financial
13 statements for FY 2000-2005, as well as the corresponding reports on SEC Form 10-K and press
14 releases. By reason of his executive positions at the Company and ownership of KLA-Tencor stock,
15 Hall was a controlling person of KLA-Tencor and had the power and influence, and exercised the
16 same, to cause KLA-Tencor to engage in the conduct detailed with particularity herein. Based on his
17 knowledge of material non-public information regarding the Company, defendant Hall violated Cal.
18 Corp. Code §§25402 and 25502.5 by selling 12,300 KLA-Tencor shares for insider trading proceeds
19 of \$607,060 during the Relevant Period.

20 63. Defendant Boehlke was, from April 1997 to 2000, EVP and CFO. Defendant
21 Boehlke joined KLA-Tencor in April 1983 as VP and General Manager of the RAPID Division.
22 During the next seven years he became Senior VP and then EVP in charge of several operating
23 divisions, including RAPID, WISARD and ATS. He was COO from August 1989 until July 1990,
24 when he became CFO. Because of Boehlke's position and history with the Company, he knew
25 adverse non-public information about the business of KLA-Tencor, as well as its finances, markets
26 and present and future business prospects, via access to internal corporate documents, conversations
27 and connections with other corporate officers and employees, attendance at management meetings,
28 and via reports and other information provided to him in connection therewith. Boehlke actively

1 participated in the preparation, review and approval of KLA-Tencor's publicly reported financial
2 results and financial statements as well as the corresponding reports on SEC Form 10-K and press
3 releases. During the Relevant Period, Boehlke received backdated stock options. In addition, during
4 the Relevant Period between August 1, 1997 and March 3, 2000, Boehlke sold 352,400 shares of
5 KLA-Tencor stock for insider trading proceeds of \$14,136,130.

6 64. Defendant Tompkins has been a director of the Company since April 1997.
7 Previously, Tompkins served as CEO from May 1997 until July 1998 and as Chairman of the Board
8 from July 1998 to June 1999. Tompkins was President, CEO and Chairman of the Board of Tencor
9 Instruments. During the Relevant Period, Tompkins actively participated in the preparation, review
10 and approval of KLA-Tencor's publicly reported financial results and financial statements for FY
11 1997-2005, as well as the corresponding reports on SEC Form 10-K and press releases. By reason of
12 his Board membership and ownership of KLA-Tencor stock, Tompkins was a controlling person of
13 KLA-Tencor and had the power and influence, and exercised the same, to cause KLA-Tencor to
14 engage in the conduct detailed with particularity herein. Based on his knowledge of material non-
15 public information regarding the Company, defendant Tompkins violated Cal. Corp. Code §§25402
16 and 25502.5 by selling 670,049 KLA-Tencor shares for insider trading proceeds of \$31.5 million
17 during the Relevant Period.

18 65. Defendant Urbanek has been a director of the Company since April 1997. From
19 August 1991 until April 1997, Urbanek was a director of Tencor Instruments prior to its merger with
20 KLA Instruments. During the Relevant Period, Urbanek actively participated in the preparation,
21 review and approval of KLA-Tencor's publicly reported financial results and financial statements for
22 FY 1997-2005, as well as the corresponding reports on SEC Form 10-K and press releases. By
23 reason of her Board membership and ownership of KLA-Tencor stock, Urbanek was a controlling
24 person of KLA-Tencor and had the power and influence, and exercised the same, to cause KLA-
25 Tencor to engage in the conduct detailed with particularity herein. Based on her knowledge of
26 material non-public information regarding the Company, defendant Urbanek violated Cal. Corp.
27 Code §§25402 and 25502.5 by selling 9,149 KLA-Tencor shares for insider trading proceeds of
28 \$448,324 during the Relevant Period.

EXHIBIT 3
Part 2 of 3

1 66. Defendant Bingham has been a director of the Company since October 1999. During
2 the Relevant Period, Bingham actively participated in the preparation, review and approval of KLA-
3 Tencor's publicly reported financial results and financial statements for FY 2000-2005, as well as
4 the corresponding reports on SEC Form 10-K and press releases. By reason of his Board
5 membership and ownership of KLA-Tencor stock, Bingham was a controlling person of KLA-
6 Tencor and had the power and influence, and exercised the same, to cause KLA-Tencor to engage in
7 the conduct detailed with particularity herein. Based on his knowledge of material non-public
8 information regarding the Company, defendant Bingham violated Cal. Corp. Code §§25402 and
9 25502.5 by selling 5,000 KLA-Tencor shares for insider trading proceeds of \$263,100 during the
10 Relevant Period.

11 67. Defendant Bond has been a director of the Company since August 2000. During the
12 Relevant Period, Bond actively participated in the preparation, review and approval of KLA-
13 Tencor's publicly reported financial results and financial statements for FY 2000-2005, as well as
14 the corresponding reports on SEC Form 10-K and press releases. By reason of his Board
15 membership and ownership of KLA-Tencor stock, Bond was a controlling person of KLA-Tencor
16 and had the power and influence, and exercised the same, to cause KLA-Tencor to engage in the
17 conduct detailed with particularity herein. Based on his knowledge of material non-public
18 information regarding the Company, defendant Bond violated Cal. Corp. Code §§25402 and 25502.5
19 by selling 5,000 KLA-Tencor shares for insider trading proceeds of \$253,050 during the Relevant
20 Period.

21 68. Defendant Barnholt has been a director of the Company since 1995. During the
22 Relevant Period, Barnholt actively participated in the preparation, review and approval of KLA-
23 Tencor's publicly reported financial results and financial statements for FY 1995-2005, as well as
24 the corresponding reports on SEC Form 10-K and press releases. By reason of his Board
25 membership and ownership of KLA-Tencor stock, Barnholt was a controlling person of KLA-
26 Tencor and had the power and influence, and exercised the same, to cause KLA-Tencor to engage in
27 the conduct detailed with particularity herein. Based on his knowledge of material non-public
28 information regarding the Company, defendant Barnholt violated Cal. Corp. Code §§25402 and

1 25502.5 by selling 29,000 KLA-Tencor shares for insider trading proceeds of \$1.4 million during the
2 Relevant Period.

3 69. Defendant Kaufman has been a director of the Company since November 2002.
4 During the Relevant Period, Kaufman actively participated in the preparation, review and approval
5 of KLA-Tencor's publicly reported financial results and financial statements for FY 2003-2005, as
6 well as the corresponding reports on SEC Form 10-K and press releases. By reason of his Board
7 membership and ownership of KLA-Tencor stock, Kaufman was a controlling person of KLA-
8 Tencor and had the power and influence, and exercised the same, to cause KLA-Tencor to engage in
9 the conduct detailed with particularity herein.

10 70. Defendant Elkus, during the Relevant Period and since April 1997, was a director of
11 the Company and during the Relevant Period sat on the Company's Audit Committee which was
12 responsible for overseeing the accounting and financial reporting processes. Elkus actively
13 participated in the preparation, review and approval of KLA-Tencor's publicly reported financial
14 results and financial statements for FY 1999-2005, as well as the corresponding reports on SEC
15 Form 10-K and press releases. Elkus also sat on the Company's Nominating and Governance
16 Committee in 2003. By reason of his Board membership and ownership of KLA-Tencor stock,
17 Elkus was a controlling person of KLA-Tencor and had the power and influence, and exercised the
18 same, to cause KLA-Tencor to engage in the conduct detailed with particularity herein. During the
19 Relevant Period, Elkus violated Cal. Corp. Code §§25402 and 25502.5 by selling 155,416 shares of
20 KLA stock for proceeds of more than \$7 million.

21 71. Defendant Nichols was, during the Relevant Period, VP and General Counsel for the
22 Company. Because of Nichols' position with KLA-Tencor, he knew adverse non-public information
23 about the business of KLA-Tencor, as well as its finances, markets and present and future business
24 prospects, via access to internal corporate documents, conversations and connections with other
25 corporate officers and employees, attendance at management meetings, and via reports and other
26 information provided to him in connection therewith. Defendant Nichols actively participated in the
27 preparation, review and approval of KLA-Tencor's publicly reported financial results and financial
28 statements, as well as the corresponding reports on SEC Form 10-K and press releases.

1 72. Defendant Chamberlain was, during the Relevant Period, a director of the Company
2 and had been a director since 1982. Chamberlain sat on the Company Compensation Committee
3 from 1995-1999, and was a member of the Company's Audit Committee in 2000. During the
4 Relevant Period, defendant Chamberlain violated Cal. Corp. Code §§25402 and 25502.5 by selling
5 81,764 shares for proceeds of \$4,839,107. Because of defendant Chamberlain's position with KLA-
6 Tencor, he knew adverse non-public information about the business of KLA-Tencor, as well as its
7 finances, markets and present and future business prospects, via access to internal corporate
8 documents, conversations and connections with other corporate officers and employees, attendance
9 at management meetings, and via reports and other information provided to him in connection
10 therewith. Defendant Chamberlain actively participated in the preparation, review and approval of
11 KLA-Tencor's publicly reported financial results and financial statements during the Relevant
12 Period, as well as the corresponding reports on SEC Form 10-K and press releases.

13 73. Defendant Schnitzer was, during the Relevant Period, EVP of the Company. From
14 June 1997 to October 1998 he was EVP, Human Resources. From July 1993 to June 1997 he was
15 Group VP responsible for RAPID, SEMSpec, Prism and manufacturing for WISARD and RAPID.
16 From 1989 to July 1993 he was VP and General Manager of the WISARD Division. Defendant
17 Schnitzer joined KLA-Tencor in July 1978 and held a series of other management positions.
18 Because of Schnitzer's position with KLA-Tencor, he knew adverse non-public information about
19 the business of KLA-Tencor, as well as its finances, markets and present and future business
20 prospects, via access to internal corporate documents, conversations and connections with other
21 corporate officers and employees, attendance at management meetings, and via reports and other
22 information provided to him in connection therewith. During the Relevant Period, defendant
23 Chamberlain violated Cal. Corp. Code §§25402 and 25502.5 by selling 471,664 shares of KLA-
24 Tencor stock for insider trading proceeds of \$26,807,656.

25 74. Defendant Dickerson, during the Relevant Period and since 1999, served as COO of
26 the Company, and President of the Company since 2002. Dickerson has held management or
27 executive management positions at the Company since 1994, including EVP of the Customer Group
28 and Group VP of the Wafer Inspection Division. Because of Dickerson's position with KLA-

1 Tencor, he knew adverse non-public information about the business of KLA-Tencor, as well as its
2 finances, markets and present and future business prospects, via access to internal corporate
3 documents, conversations and connections with other corporate officers and employees, attendance
4 at management meetings, and via reports and other information provided to him in connection
5 therewith. Defendant Dickerson actively participated in the preparation, review and approval of
6 KLA-Tencor's publicly reported financial results and financial statements, as well as the
7 corresponding reports on SEC Form 10-K and press releases. During the Relevant Period,
8 Dickerson violated Cal. Corp. Code §§25402 and 25502.5 by selling 574,000 KLA-Tencor shares
9 for more than \$27 million in insider trading proceeds.

10 **DEFENDANTS' DUTIES**

11 75. Each officer and director of KLA-Tencor named herein owed the Company and
12 KLA-Tencor shareholders the duty to exercise a high degree of care, loyalty and diligence in the
13 management and administration of the affairs of the Company, as well as in the use and preservation
14 of its property and assets. The conduct of KLA-Tencor's directors and officers complained of herein
15 involves knowing, intentional and culpable violations of their obligations as officers and directors of
16 KLA-Tencor. Further, the misconduct of KLA-Tencor's officers has been ratified by KLA-Tencor's
17 Board, which has failed to take any legal action on behalf of the Company against them.

18 76. By reason of their positions as officers, directors and fiduciaries of KLA-Tencor and
19 because of their ability to control the business and corporate affairs of the Company, the Defendants
20 owed KLA-Tencor and its shareholders fiduciary obligations of candor, trust, loyalty and care, and
21 were required to use their ability to control and manage KLA-Tencor in a fair, just, honest and
22 equitable manner, and to act in furtherance of the best interests of KLA-Tencor and its shareholders
23 so as to benefit all shareholders equally and not in furtherance of their personal interest or benefit. In
24 addition, as officers and/or directors of a publicly held company, the Defendants had a duty to
25 refrain from utilizing their control over KLA-Tencor to divert assets to themselves via improper
26 and/or unlawful practices. Defendants also had a duty to promptly disseminate accurate and truthful
27 information with respect to the Company's operations, earnings and compensation practices.

1 77. Because of their positions of control and authority as directors or officers of KLA-
2 Tencor, each of the Defendants was able to and did, directly and indirectly, control the wrongful acts
3 complained of herein. As to the Defendants who served as directors, these acts include: (a)
4 agreement to and/or acquiescence in Defendants' option backdating scheme; and (b) willingness to
5 cause KLA-Tencor to disseminate false Proxy Statements for FY 1995-2005, which Proxy
6 Statements failed to disclose Defendants' option backdating scheme and omitted the fact that
7 executive officers were allowed to backdate their stock option grants in order to manipulate the
8 strike price of the stock options they received. Because of their positions with KLA-Tencor, each of
9 the Defendants was aware of these wrongful acts, had access to adverse non-public information and
10 was required to disclose these facts promptly and accurately to KLA-Tencor shareholders and the
11 financial markets but failed to do so.

12 78. Between FY 1995 and 2005, Defendants repeated in each Proxy Statement that the
13 stock option grants made during that period carried an exercise price that was *not less than* the fair
14 market value of KLA-Tencor stock on the date granted, as calculated by the public trading price of
15 the stock at the market's close on that date. However, Defendants concealed until 2006 that the
16 stock option grants were repeatedly and consciously *backdated* to ensure that the strike price
17 associated with the option grants was at or near the lowest trading price for that fiscal period. Due to
18 Defendants' breach of their fiduciary duty in the administration of the stock option plans, plaintiffs
19 seek to have the directors' and officers' plans voided and gains from those plans returned to the
20 Company. In the alternative, plaintiffs seek to have all of the unexercised options granted to
21 Defendants between 1994 and 2002 cancelled, the financial gains obtained via the exercise of such
22 options returned to the Company and to have Defendants revise the Company's financial statements
23 to reflect the truth concerning these option grants.

24 79. To discharge their duties, the directors of KLA-Tencor were required to exercise
25 reasonable and prudent supervision over the management, policies, practices and controls of the
26 business and financial affairs of KLA-Tencor. By virtue of such duties, the officers and directors of
27 KLA-Tencor were required, among other things, to:

1 (a) Manage, conduct, supervise and direct the business affairs of KLA-Tencor in
2 accordance with all applicable law (including federal and state laws, government rules and
3 regulations and the charter and bylaws of KLA-Tencor);

4 (b) Neither engage in self-dealing nor knowingly permit any officer, director or
5 employee of KLA-Tencor to engage in self-dealing;

6 (c) Neither violate nor knowingly permit any officer, director or employee of
7 KLA-Tencor to violate applicable laws, rules and regulations;

8 (d) Remain informed as to the status of KLA-Tencor's operations, including its
9 practices in relation to the cost of allowing the pervasive backdating and improperly accounting for
10 such, and upon receipt of notice or information of imprudent or unsound practices, to make a
11 reasonable inquiry in connection therewith, and to take steps to correct such conditions or practices
12 and make such disclosures as are necessary to comply with federal securities laws and their duty of
13 candor to the Company's shareholders;

14 (e) Prudently protect the Company's assets, including taking all necessary steps
15 to recover corporate assets (cash, stock options) improperly paid to Company executives and
16 directors together with the related costs (professional fees) proximately caused by the illegal conduct
17 described herein;

18 (f) Establish and maintain systematic and accurate records and reports of the
19 business and affairs of KLA-Tencor and procedures for the reporting of the business and affairs to
20 the Board and to periodically investigate, or cause independent investigation to be made of, said
21 reports and records;

22 (g) Maintain and implement an adequate, functioning system of internal legal,
23 financial and accounting controls, such that KLA-Tencor's financial statements – including its
24 expenses, accounting for stock option grants and other financial information – would be accurate and
25 the actions of its directors would be in accordance with all applicable laws;

26 (h) Exercise control and supervision over the public statements to the securities
27 markets and trading in KLA-Tencor stock by the officers and employees of KLA-Tencor; and
28

1 (i) Supervise the preparation and filing of any financial reports or other
2 information required by law from KLA-Tencor and to examine and evaluate any reports of
3 examinations, audits or other financial information concerning the financial affairs of KLA-Tencor
4 and to make full and accurate disclosure of all material facts concerning, *inter alia*, each of the
5 subjects and duties set forth above.

6 80. Each Defendant, by virtue of his or her position as a director and/or officer, owed to
7 the Company and to its shareholders the fiduciary duties of loyalty, good faith and the exercise of
8 due care and diligence in the management and administration of the affairs of the Company, as well
9 as in the use and preservation of its property and assets. The conduct of the Defendants complained
10 of herein involves a knowing and culpable violation of their obligations as directors and/or officers
11 of KLA-Tencor, the absence of good faith on their part, and a reckless disregard for their duties to
12 the Company and its shareholders, which Defendants were aware or should have been aware posed a
13 risk of serious injury to the Company. The conduct of the Defendants who were also officers and/or
14 directors of the Company during the Relevant Period has been ratified by the Defendants who served
15 as directors who comprised KLA-Tencor's entire Board during the Relevant Period.

16 81. Defendants breached their duties of loyalty and good faith by allowing or by
17 themselves causing the Company to misrepresent its financial results and prospects, as detailed
18 herein *infra*, and by failing to prevent the Defendants from taking such illegal actions. In addition,
19 as a result of Defendants' illegal actions and course of conduct during the Relevant Period, the
20 Company is now the subject of an SEC investigation. As a result, KLA-Tencor has expended and
21 will continue to expend significant sums of money. Such expenditures include, but are not limited
22 to:

- 23 (a) Improvidently paid executive compensation;
- 24 (b) Increased capital costs as a result of the loss of market capitalization and the
25 Company's damaged reputation in the investment community;
- 26 (c) Professional costs associated with the SEC's inquiry and the U.S. Attorney's
27 investigation;
- 28

1 (d) Costs incurred to carry out internal investigations, including legal fees paid to
2 outside counsel; and

3 (e) Incurring possible IRS penalties for improperly reporting compensation.

4 82. These actions have irreparably damaged KLA-Tencor's corporate image and
5 goodwill. For at least the foreseeable future, KLA-Tencor will suffer from what is known as the
6 "liar's discount," a term applied to the stocks of companies who have been implicated in illegal
7 behavior and have misled the investing public, such that KLA-Tencor's ability to raise equity capital
8 or debt on favorable terms in the future is now impaired.

9 **AIDING AND ABETTING AND CONCERTED ACTION**

10 83. In committing the wrongful acts alleged herein, Defendants have pursued or joined in
11 the pursuit of a common course of conduct, and have acted in concert with one another in
12 furtherance of their common plan or design. In addition to the wrongful conduct herein alleged as
13 giving rise to primary liability, Defendants further aided and abetted and/or assisted each other in
14 breach of their respective duties.

15 84. At relevant times, Defendants collectively and individually initiated a course of
16 conduct which was designed to and did: (a) conceal the fact that the Company was over-paying its
17 directors, officers and employees and improperly misrepresenting its financial results, in order to
18 allow Defendants to artificially inflate the price of the Company's shares; (b) maintain Defendants'
19 executive and directorial positions at KLA-Tencor and the profits, power and prestige which
20 Defendants enjoyed as a result of these positions; (c) deceive the investing public, including
21 shareholders of KLA-Tencor, regarding Defendants' management of KLA-Tencor's operations, the
22 Company's financial health and stability, and future business prospects, which had been
23 misrepresented by Defendants throughout the Relevant Period; and (d) allow several of the
24 Company's officers and directors to sell millions of dollars worth of Company stock at inflated
25 prices. In furtherance of this course of conduct, Defendants collectively and individually took the
26 actions set forth herein.

27 85. Defendants engaged in a common course of conduct commencing by at least 1995
28 and continuing thereafter. During this time, Defendants caused the Company to conceal the true fact

1 that KLA-Tencor was over-compensating its directors, officers and employees and misrepresenting
2 its financial results. In addition, Defendants also made other specific, false statements about KLA-
3 Tencor's financial performance and future business prospects, as alleged herein.

4 86. The purpose and effect of Defendants' common enterprise and/or common course of
5 conduct was, among other things, to disguise Defendants' violations of law, breaches of fiduciary
6 duty, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment; to
7 conceal adverse information concerning the Company's operations, financial condition, and future
8 business prospects; and to artificially inflate the price of KLA-Tencor common stock so they could:
9 (a) dispose of millions of dollars of their own stock, and (b) protect and enhance their executive and
10 directorial positions and the substantial compensation and prestige they obtained as a result thereof.

11 87. Defendants accomplished their common enterprise and/or common course of conduct
12 by causing the Company to purposefully, recklessly or negligently grant under-priced stock options
13 and to misrepresent its financial results. Because the actions described herein occurred under the
14 authority of the Board, each of the Defendants was a direct, necessary, and substantial participant in
15 the common enterprise and/or common course of conduct complained of herein.

16 88. Each of the Defendants aided and abetted and rendered substantial assistance in the
17 wrongs complained of herein. In taking such actions to substantially assist the commission of the
18 wrongdoing complained of herein, each of the Defendants acted with knowledge of the primary
19 wrongdoing, substantially assisted the accomplishment of that wrongdoing, and was aware of his or
20 her overall contribution to and furtherance of the wrongdoing.

21 **FACTUAL ALLEGATIONS**

22 89. KLA-Tencor is a supplier of process control and yield management solutions for the
23 semiconductor and related microelectronics industries. The Company's portfolio of products,
24 software, analysis, services and expertise is designed to help integrated circuit manufacturers
25 manage yield throughout the entire fabrication process, from research and development to final
26 mass-production yield analysis. The Company provides inline wafer defect monitoring; reticule and
27 photomask defect inspection; critical dimension metrology; wafer overlay; film and surface
28 measurement; and overall yield and fab-wide data analysis.

1 90. By law, Defendants owed KLA-Tencor a duty to ensure that the Company's financial
2 reporting fairly presented, in all material respects, the operations and financial condition of the
3 Company. To adequately carry out these duties, it is necessary for Defendants to know and
4 understand the material non-public information to be either disclosed or omitted from the
5 Company's public statements. This material non-public information included the problems KLA-
6 Tencor faced because of its deficient internal controls. Furthermore, Defendants Bingham, Bond,
7 Elkus and Kaufman, as members of the Audit Committee of KLA-Tencor's Board, had a special
8 duty to know and understand this material information as set out in the Audit Committee's charter,
9 which provides that the Audit Committee is responsible for reviewing, in conjunction with
10 management, the Company's policies generally with respect to the Company's earnings press
11 releases and with respect to financial information and earnings guidance provided to Defendants as
12 KLA-Tencor's directors and officers. In addition, Defendants Barnholt, Urbanek, and Bond, as
13 members of the Compensation Committee had a special duty to know and execute its oversight and
14 execution of the Company's stock option issuance policies.

15 91. Moreover, Defendants had ample opportunity to discuss this material information
16 with management and fellow directors at any of the scores of Board meetings that occurred during
17 the Relevant Period as well as at committee meetings of the Board. Despite these duties, Defendants
18 negligently, recklessly, and/or intentionally caused or allowed, by their actions or conscious
19 inactions, the misleading statements to be disseminated by KLA-Tencor to the Company's
20 shareholders.

21 92. Specifically, the reported dates KLA-Tencor stock options were granted differed from
22 the dates on which the options were actually granted. The practice applied to stock option grants
23 made between 1995 and 2002, which allowed directors, officers and employees to make more
24 money on their options because it set a lower "strike price" at which the options could be exercised,
25 allowing employees to pocket larger profits.

26 93. By manipulating the grant dates, KLA-Tencor was able to provide executives and
27 employees with the lowest possible exercise price. The lower the exercise price, the worse off KLA-
28 Tencor was because it would receive less cash for the option purchased. However, such

1 manipulation would allow the director, officer or other employee to increase the amount he or she
2 would pocket by a commensurate amount. So, as insiders, Defendants were motivated to “cherry
3 pick” the dates on which the prices would be set. Certain of KLA-Tencor’s grants are described
4 below (adjusted for stock splits).

5 **1995 False Proxy Statement**

6 94. On October 17, 1995, the Company filed its Form 14-A Proxy Statement with the
7 SEC. In the Proxy Statement the Company described its Stock Option Plan and administration of
8 the plan by the Board or a committee of the Board, and that generally, stock options are issued at the
9 market price on the date of the grant:

10 Grants of stock options to executive officers are based upon each officer’s relative
11 position, responsibilities, historical and expected contributions to the Company, and
12 the officer’s existing stock ownership and previous option grants, with primary
13 weight given to the executive officer’s relative rank and responsibilities. Initial stock
14 option grants designed to recruit an executive officer to join the Company may be
based on negotiations with the officer and with reference to historical option grants
to existing officers. *Stock options are granted at market price on the date of grant
and will provide value to the executive officers only when the price of the
Company’s Common Stock increases over the exercise price.*

15 **1996 False Proxy Statement**

16 95. On October 11, 1996, the Company filed its Form 14-A Proxy Statement with the
17 SEC. The Proxy Statement made the following false and misleading statements regarding the
18 administration of the Stock Option Plan while at the same time soliciting shareholder votes for
19 amendments thereto:

20 Terms and Conditions of Options. Each option granted under the Option Plan is
21 evidenced by a written agreement between the Company and the optionee specifying
22 the number of shares subject to the option and the other terms and conditions of the
option, consistent with the requirements of the plan. *The exercise price of each
option granted under the Option Plan must equal at least the fair market value of a
share of the Company’s Common Stock on the date of grant.*

23 **1997 False Proxy Statement**

24 96. On October 6, 1997, the Company filed its Form 14-A Proxy Statement with the SEC
25 and distributed the same to the Company shareholders. The Proxy Statement made the following
26 false and misleading statements regarding the administration of the Company’s Stock Option Plans
27 and grants to executive officers:
28

1 Grants of stock options to executive officers are based upon each executive officer's
2 relative position, responsibilities, historical and expected contributions to the
3 Company, and the executive officer's previous option grants, with primary weight
4 given to the executive officer's relative rank and responsibilities. *Stock options are
granted at market price on the date of grant and will provide value to the executive
officers only when the price of the Company's Common Stock increases over the
exercise price.*

5 **September 28, 1998 Proxy and 1998 Option Grants**

6 97. On September 28, 1998, the Company filed a Form 14-A Proxy Statement with the
7 SEC. The Proxy Statement made the following false and misleading statements regarding the
8 Company Stock Option Plans:

9 **COMPENSATION OF DIRECTORS**

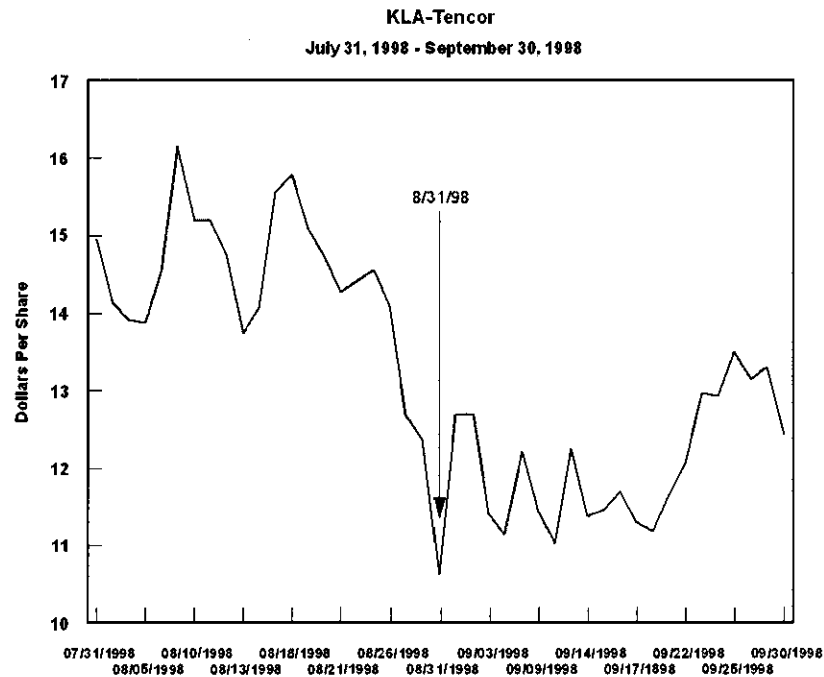
10 The Company's Outside Directors Stock Option Plan (the "Director Plan") as
11 adopted by the Board of Directors and approved by the stockholders, provides for the
12 grant of an option to purchase 2,500 shares of Common Stock of the Company to
13 each of the Company's non-employee directors on the date on which such person is
elected a director. . . . *The Director Plan provides that the exercise price shall be
equal to the fair market value of the Common Stock on the date of grant of the
option. . . .*

14 . . . *The 1998 Director Plan provides that the exercise price shall be equal to
the fair market value of the Common Stock on the date of grant of the option.
Options granted under the 1998 Director Plan shall become exercisable
immediately upon the date of grant.*

15 * * *

16
17 *Grants of stock options to executive officers* are based upon each executive officer's
18 relative position, responsibilities, historical and expected contributions to the
19 Company, and the executive officer's existing stock ownership and previous option
20 grants, with primary weight given to the executive officer's relative rank and
responsibilities. *Stock options are granted at market price on the date of grant and
will provide value to the executive officers only when the price of the Company's
Common Stock increases over the exercise price.*

21 98. Defendants dated many of KLA-Tencor's 1998 option grants as of August 31, 1998,
22 at \$10.625 per share – *not only the low for the month but also for the year.* The stock traded
23 between \$10.625 and \$16.1563 per share during August 1998. The stock traded between \$10.625
24 and \$24.00 per share during 1998. Defendants Levy and Schroeder each received 204,272 options at
25 \$10.625 per share. Also, on August 31, 1998, defendant Tompkins received 50,809 options,
26 defendant Boehlke received 54,436 options, defendant Schnitzer received 54,436 options and
27 defendant Dickerson received 62,882 options.
28



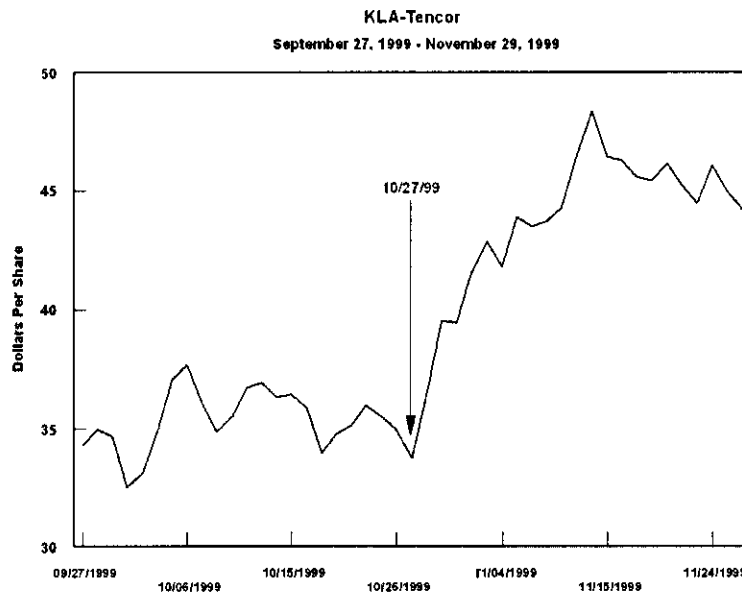
October 15, 1999 Proxy and 1999 Option Grants

99. On October 15, 1999, the Company filed its Form 14-A Proxy Statement. The Proxy Statement reiterated the material terms of stock option grants, including the statement that the “exercise price of the options is the fair market value of the common stock on the date of grant.” Grants of stock options to executive officers are based upon each executive officer’s responsibilities, historical and expected contributions to the Company, and the executive officer’s existing stock ownership and previous option grants, with primary weight given to the executive officer’s relative rank and responsibilities.

Stock options are granted at market price on the date of grant and provide value to the executive officers only when the price of the Company’s Common Stock increases over the exercise price.

100. Defendants dated KLA-Tencor’s 1999 option grants as of October 27, 1999, at \$33.75 per share – nearly the lowest price at which the stock traded that month, when the stock traded between \$33.125 and \$39.5938 per share. Defendants Levy and Schroeder received 90,000 and 150,000 options, respectively, at this price. In addition, on October 27, 1999, defendants Tompkins

1 received 10,000 options, Boehlke received 60,000 options, Dickerson received 100,000 options and
 2 Schnitzer received 50,000 options.



October 6, 2000 Proxy Statement and 2000 Option Grants

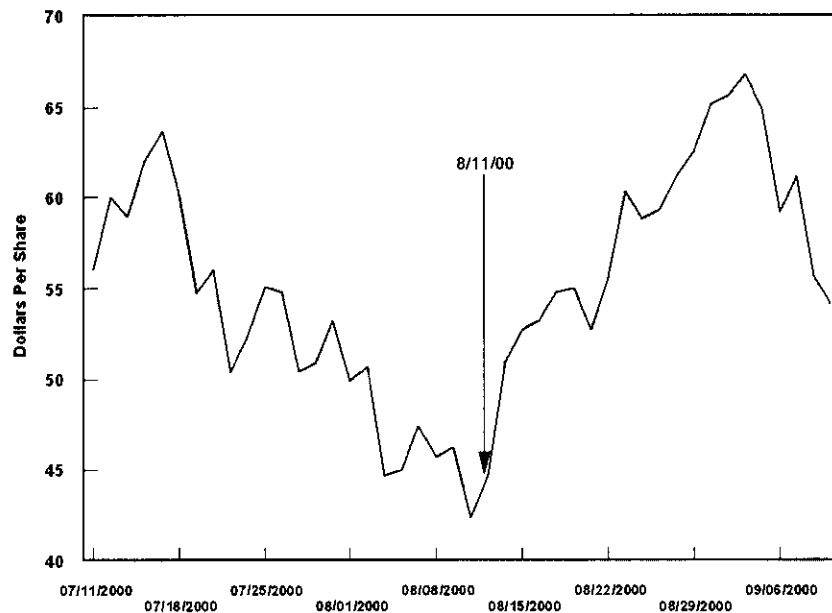
15 101. The October 6, 2000 Proxy Statement made the following false and misleading
 16 statements regarding the administration and issuance of stock option grants to executive officers:

17 Grants of stock options to executive officers are based upon each executive officer's
 18 relative position, . . . *Stock options are granted at market price on the date of grant*
 19 *and will provide value to the executive officers only when the price of the*
 20 *Company's Common Stock increases over the exercise price.*

20 102. Defendants dated KLA-Tencor's 2000 option grants on several dates, including one
 21 which was the lowest price for the year. Defendants Levy and Schroeder received 37,901 and
 22 75,800 options, respectively, at \$44.69 per share on August 11, 2000, nearly the lowest price at
 23 which the stock traded that month, when the stock traded between \$42.375 and \$65.625 per share.
 24 Defendants Levy and Schroeder received 18,951 and 37,900 options, respectively, at \$26.25 per
 25 share on November 10, 2000; defendant Tompkins (10,000) and defendant Dickerson (32,500) also
 26 received grants on November 10, 2000 – *not only the low for the month but also the low for the*
 27 *year*. The stock traded as high as \$33.50 during the month and as high as \$97.4375 during the year:

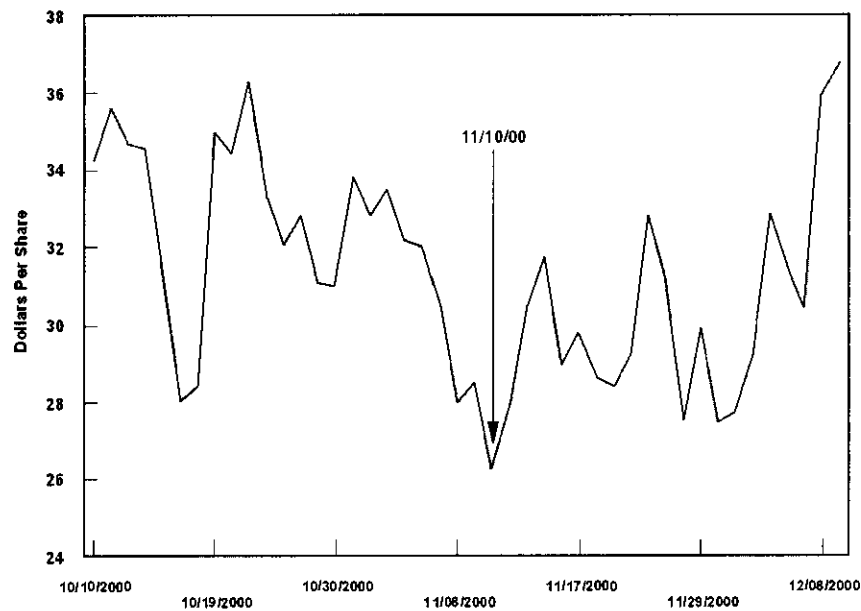
KLA-Tencor

July 11, 2000 - September 11, 2000



KLA-Tencor

October 10, 2000 - December 11, 2000



September 28, 2001 Proxy Statement and 2001 Option Grants

103. On September 28, 2001, the Company filed its Form 14-A Proxy Statement with the SEC. The Proxy Statement made the following false and misleading statement regarding the issuance of stock options to executive officers:

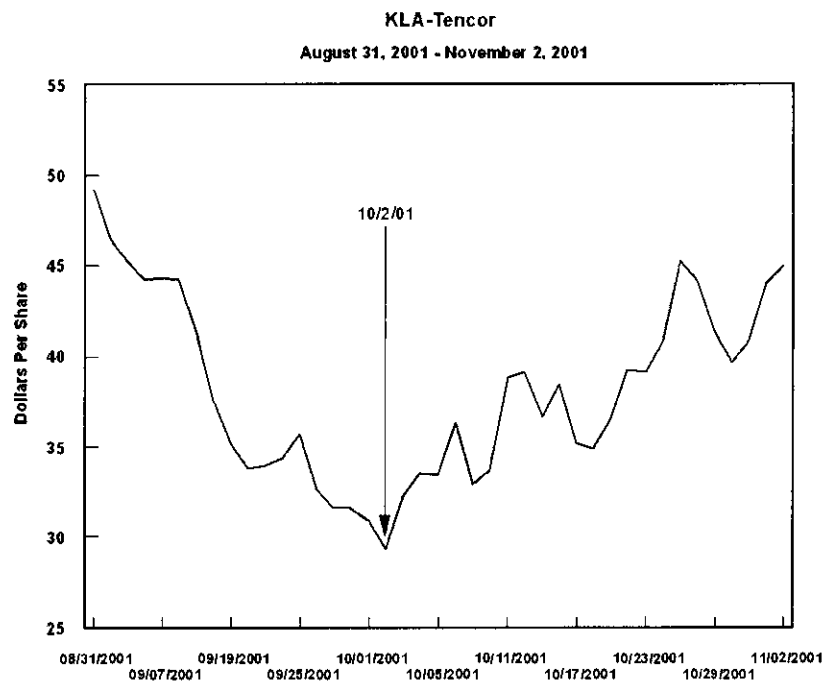
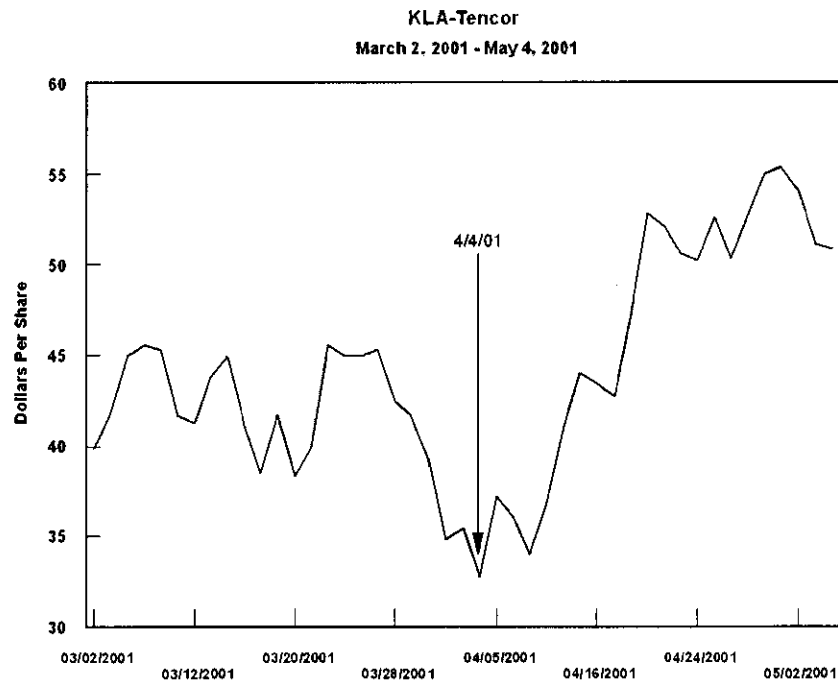
Grants of stock options to executive officers are based upon each executive officers' relative position, responsibilities, historical and expected contributions to the

1 Company, and the executive officer's existing stock ownership and previous option
2 grants, with primary weight given to the executive officer's relative rank and
3 responsibilities. *Stock options are granted at market price on the date of grant and
will provide value to the executive officers only when the price of the Company's
Common Stock increases over the exercise price.*

4 104. On the same September 28, 2001 Proxy Statement, the Company's Audit Committee
5 issued a report providing substantial assurances that it had comprehensively reviewed and discussed
6 the Company's financial statements and internal controls prior to approving the financial statements.

7 During each of its five meetings during fiscal year 2001, the Audit Committee met
8 with the senior members of the Company's financial management team, the
9 independent auditors and the Company's General Counsel when appropriate. The
10 Audit Committee's chairman was responsible for preparing an agenda for each
11 meeting. *During the Committee's private sessions, the Audit Committee met with
the Company's independent auditors and separately with the Company's Chief
Financial Officer. The parties candidly discussed financial management,
accounting and internal controls.*

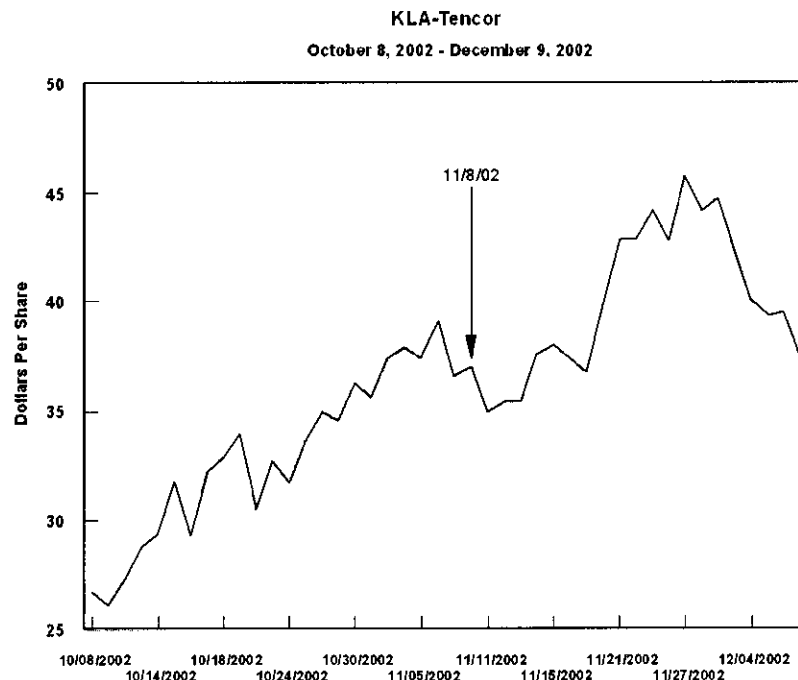
12 105. Further, Defendants dated KLA-Tencor's 2001 option grants on several dates,
13 including two which were at the lowest price of the month in which the options were granted.
14 Defendants Levy, Schroeder and Dickerson received 18,951, 37,900 and 32,500 options,
15 respectively, at \$32.75 per share on April 4, 2001 – *the low of the month*. The stock traded as high
16 as \$54.96 per share in April 2001. Defendants Levy, Schroeder, Kispert and Dickerson received
17 28,425, 341,100, 60,000 and 105,000 options, respectively, at \$29.31 per share dated October 2,
18 2001 – *again the low for the month*. The stock traded as high as \$45.25 per share in October 2001:
19
20
21
22
23
24
25
26
27
28



106. On September 25, 2002, the Company filed its Form 14-A Proxy Statement with the SEC. The Proxy Statement made the following false and misleading statements regarding issuance of stock options to executive officers:

1 Grants of stock options to executive officers . . . *Stock options are granted at*
 2 *market price on the date of grant and will provide value to the executive officers*
 3 *only when the price of the Company's Common Stock increases over the exercise*
 4 *price.*

5 107. Defendants dated KLA-Tencor's 2002 option grants as of November 8, 2002, at
 6 \$37.05 per share – nearly the lowest price at which the stock traded that month, when the stock
 7 traded between \$34.97 and \$45.80 per share. Defendants Schroeder, Kispert and Wallace received
 8 31,450, 12,500 and 12,500 options, respectively, at this price:



24 THE STOCK OPTION BACKDATING SCHEME AND ITS IMPACT 25 ON KLA-TENCOR'S FINANCIAL STATEMENTS

26 108. Since FY 1995, Defendants caused KLA-Tencor to report false and misleading
 27 financial results which materially understated its compensation expenses and thus overstated its
 28 earnings as follows:

	Fiscal Year	Reported Earnings (in millions)	Reported Diluted EPS
1			
2	1995	\$105	\$1.34
3	1996	\$197	\$1.17
4	1997	\$105	\$0.62
5	1998	\$134	\$0.76
6	1999	\$39	\$0.22
7	2000	\$253	\$1.32
8	2001	\$67	\$0.34
9	2002	\$216	\$1.10
10	2003	\$137	\$0.70
11	2004	\$244	\$1.21
12	2005	\$467	\$2.32
13	1Q-3Q 2006	\$251	\$1.23

109. In effect, between 1995 and 2006, Defendants caused KLA-Tencor shares to trade at artificially inflated levels by issuing a series of materially false and misleading statements regarding the Company's financial results. These financial results misrepresented and omitted to disclose that the Company had problems with its internal controls that prevented it from issuing accurate financial reports and that because of improperly recorded stock-based compensation expenses the Company's publicly reported financial statements and results presented an inflated view of KLA-Tencor's earnings and EPS.

The FY 1995 Form 10-K

110. On September 27, 1995, the Company filed its FY 1995 Form 10-K with the SEC signed by William Turner ("Turner"), Levy, Schroeder, Boehlke, Barnholt, Chamberlain, Samuel Rubinovitz ("Rubinovitz") and Yoshio Nishi ("Nishi"). The FY 1995 Form 10-K was simultaneously distributed to shareholders and the public. The FY 1995 Form 10-K included KLA-Tencor's FY 1995 financial statement which were materially false and misleading and presented in violation of GAAP, due to improper accounting for the backdated stock options. As a result, KLA-Tencor's compensation expense was understated and its net earnings were overstated.

111. The September 27, 1995 Form 10-K falsely stated that the Company issued stock options in compliance with the Company's 1982 Stock Option Plan and that options issued under said plan were issued by the Board Of Directors at "not less than fair market value on the date of the grant" as follows:

Under the 1982 Stock Option Plan, as amended, 6,350,000 shares have been reserved for issuance to eligible employees and directors as either Incentive Stock Options

1 (ISO's) or nonqualified options. *Options under this plan are granted at prices*
2 *determined by the Board of Directors, but not less than the fair market value on*
3 *the date of grant*

4 **The FY 1996 Form 10-K**

5 112. On September 27, 1996, the Company filed its FY 1996 Form 10-K with the SEC
6 signed by Turner, Levy, Schroeder, Boehlke, Barnholt, Chamberlain, Robert Lorenzini, Nishi,
7 Rubinovitz and Dag Tellefsen ("Tellefsen"). The FY 1996 Form 10-K was simultaneously
8 distributed to shareholders and the public. The FY 1996 Form 10-K included KLA-Tencor's FY
9 1996 financial statements which were materially false and misleading and presented in violation of
10 GAAP, due to improper accounting for the backdated stock options. As a result, KLA-Tencor's
11 compensation expense was understated and its net earnings were overstated.

12 113. The September 27, 1996 Form 10-K made the following false and misleading
13 statement regarding the issuance of stock options under the Company's 1982 Stock Option Plan and
14 specifically and falsely stated that options were issued at not less than fair market value on the date
15 of the grant:

16 Under the 1982 Stock Option Plan, as amended, 14,900,000 shares have been
17 reserved for issuance to eligible employees and directors as either Incentive Stock
18 Options (ISO's) or nonqualified options. *Options under this plan are granted at*
19 *prices determined by the Board of Directors, but not less than the fair market value*
20 *on the date of grant, and expire ten years after the date of grant.*

21 **The FY 1997 Form 10-K**

22 114. On September 29, 1997, the Company filed its FY 1997 Form 10-K with the SEC
23 signed by Levy, Tompkins, Schroeder, Boehlke, James Bagley ("Bagley"), Barnholt, Chamberlain,
24 Elkus, Dean Morton ("Morton"), Nishi, Rubinovitz, Urbanek and Tellefsen. The FY 1997 Form 10-
25 K was simultaneously distributed to shareholders and the public. The FY 1997 Form 10-K included
26 KLA-Tencor's FY 1997 financial statements which were materially false and misleading and
27 presented in violation of GAAP, due to improper accounting for the backdated stock options. As a
28 result, KLA-Tencor's compensation expense was understated and its net earnings were overstated.

115. The September 29, 1997 Form 10-K made the following false and misleading
statement regarding the Company's issuance of employee stock options in compliance with the
applicable Stock Option Plan stating that stock options were granted at fair market value on the grant

1 date, and that the Company properly accounted for stock options under APB Opinion No. 25 as
2 follows:

3 Stock-Based Compensation Plans

4 *The Company accounts for its stock option plans and employee stock purchase*
5 *plan in accordance with provisions of the Accounting Principles Board's Opinion*
6 *No. 25 (APB OPINION NO. 25), "Accounting for Stock Issued to Employees."*
The Company's policy is to grant options at the fair market value on the date of
grant. Accordingly no compensation expense has been recorded.

7 **The FY 1998 Form 10-K**

8 116. On September 29, 1998, the Company filed its FY 1998 Form 10-K with the SEC.
9 The FY 1998 Form 10-K was simultaneously distributed to shareholders and the public. The
10 September 29, 1998 Form 10-K was signed by Levy, Tompkins, Schroeder, Boehlke, Bagley,
11 Barnholt, Chamberlain, Elkus, Morton, Nishi, Rubinovitz and Urbanek. The FY 1998 Form 10-K
12 included KLA-Tencor's FY 1998 financial statements which were materially false and misleading
13 and presented in violation of GAAP, due to improper accounting for the backdated stock options.
14 As a result, KLA-Tencor's compensation expense was understated and its net earnings were
15 overstated. The Form 10-K also falsely stated that the Company properly accounted for stock
16 options under APB Opinion No. 25:

17 STOCK-BASED COMPENSATION PLANS

18 *The Company accounts for its employee stock option plans and employee stock*
19 *purchase plan in accordance with provisions of the Accounting Principles Board's*
20 *Opinion No. 25 (APB OPINION NO. 25), "Accounting for Stock Issued to*
Employees."

21 **The FY 1999 Form 10-K**

22 117. On September 28, 1999, the Company filed its FY 1999 Form 10-K with the SEC.
23 The FY 1999 Form 10-K was simultaneously distributed to shareholders and the public signed by
24 Levy, Schroeder, Boehlke, Bagley, Barnholt, Chamberlain, Elkus, Morton, Rubinovitz and
25 Tompkins. The FY 1999 Form 10-K included KLA-Tencor's FY 1999 financial statements which
26 were materially false and misleading and presented in violation of GAAP, due to improper
27 accounting for the backdated stock options. As a result, KLA-Tencor's compensation expense was
28 understated and its net earnings were overstated.

1 118. The Form 10-K also made the specific false and misleading statement that the
2 Company properly accounted for stock options in accordance with APB Opinion No. 25:

3 STOCK-BASED COMPENSATION PLANS

4 *The Company accounts for its employee stock option plans and employee stock*
5 *purchase plan in accordance with provisions of the Accounting Principles Board's*
6 *Opinion No. 25, "Accounting for Stock Issued to Employees." The Company*
7 *provides additional proforma disclosure required by Financial Accounting Standard*
8 *(SFAS) No. 123, "Accounting for Stock-Based Compensation" (see Note 6).*

9 **The FY 2000 Form 10-K**

10 119. On September 28, 2000, the Company filed its FY 2000 Form 10-K with the SEC
11 signed by Levy, Schroeder, Kispert, Barnholt, Bingham, Bond, Elkus, Morton, Tompkins and
12 Urbanek. The FY 2000 Form 10-K was simultaneously distributed to shareholders and the public.
13 The FY 2000 Form 10-K included KLA-Tencor's FY 2000 financial statements which were
14 materially false and misleading and presented in violation of GAAP, due to improper accounting for
15 the backdated stock options. As a result, KLA-Tencor's compensation expense was understated and
16 its net earnings were overstated.

17 120. The 2000 Form 10-K falsely represented that the Company issued stock options at
18 prices not less than fair market value of the Company's common stock on the grant date:

19 STOCK OPTION AND INCENTIVE PLANS

20 The Company has authorized various stock option and management incentive plans
21 for selected employees, officers, directors, and consultants. . . .

22 *Under the Company's stock option plans, options generally have vesting periods of*
23 *four years, are exercisable for a period not to exceed ten years from the date of*
24 *issuance and are granted at prices not less than the fair market value of the*
25 *Company's common stock at the grant date.*

26 **The FY 2001 Form 10-K**

27 121. On September 21, 2001, the Company filed its FY 2001 Form 10-K with the SEC
28 signed by Levy, Schroeder, Kispert, Barnholt, Bingham, Bond, Elkus, Morton, Tompkins and
Urbanek. The FY 2001 Form 10-K was simultaneously distributed to shareholders and the public.
The FY 2001 Form 10-K included KLA-Tencor's FY 2001 financial statements which were
materially false and misleading and presented in violation of GAAP, due to its improper accounting

1 for the backdated stock options. As a result, KLA-Tencor's compensation expense was understated
2 and its net earnings were overstated.

3 122. The September 21, 2001 Form 10-K falsely represented that stock options issued
4 under the Company Incentive Stock Option Plan were issued at the fair market value of the stock on
5 the date of the grant:

6 Under KLA-Tencor's stock option plans, options generally have vesting periods of
7 four or five years, are exercisable for a period not to exceed ten years from *the date*
8 *of issuance and are granted at prices not less than the fair market value of KLA-*
9 *Tencor's common stock at the grant date.*

10 **The FY 2002 Form 10-K**

11 123. On September 20, 2002, the Company filed its FY 2002 Form 10-K with the SEC
12 signed by Levy, Schroeder, Kispert, Barnholt, Bingham, Bond, Elkus, Tompkins and Urbanek. The
13 FY 2002 Form 10-K was simultaneously distributed to shareholders and the public. The 2002 Form
14 10-K also included the false Sarbanes-Oxley certifications of Kispert and Schroeder. The FY 2002
15 Form 10-K included KLA-Tencor's FY 2002 financial statements which were materially false and
16 misleading and presented in violation of GAAP, due to its improper accounting for the backdated
17 stock options. As a result, KLA-Tencor's compensation expense was understated and its net
18 earnings were overstated.

19 124. The September 20, 2002 Form 10-K falsely represented that option grants under its
20 Incentive Stock Option Plan were issued at no less than fair market value on the date of the grant:

21 Stock Option and Incentive Plans KLA-Tencor's stock option program is a broad-
22 based, long-term retention program that is intended to attract and retain qualified
23 management and technical employees ("knowledge employees"), and align
24 stockholder and employee interests. . . . *Under KLA-Tencor's stock option plans,*
25 *options generally have vesting periods of four or five years, are exercisable for a*
26 *period not to exceed ten years from the date of issuance and are granted at prices*
27 *not less than the fair market value of KLA-Tencor's common stock at the grant*
28 *date.*

24 125. The same Form 10-K reported that in 2002 the Company granted an additional
25 227,000 options to defendant Schroeder to incentivize him as a future leader of the Company:

26 Options granted to the top five officers as a percentage of the total options granted to
27 all employees vary from year to year. In 2002, they were a higher percentage of the
28 total grants than in the other years shown as they included Board of Director
approved additional grants to *Mr. Schroeder in recognition of his future potential to*

1 *lead the corporation. The additional grants to Mr. Schroeder total 227,400 options*
2 *with vesting on said grants*

3 **The FY 2003 Form 10-K Amended September 29, 2003**

4 126. On or about September 16, 2003 (amended September 29, 2003), the Company filed
5 its FY 2003 Form 10-K with the SEC. The Form 10-K was signed by Kispert and included false
6 Sarbanes-Oxley certifications of Schroeder and Kispert. The FY 2003 Form 10-K was
7 simultaneously distributed to shareholders and the public. The FY 2003 Form 10-K included KLA-
8 Tencor's FY 2003 financial statements which were materially false and misleading and presented in
9 violation of GAAP, due to improper accounting for the backdated stock options. As a result, KLA-
10 Tencor's compensation expense was understated and its net earnings were overstated. The Form 10-
11 K also falsely represented that it properly accounted for stock options under APB Opinion No. 25
12 and that all stock options granted under the Plan were equal in value to the common stock on the
13 grant date:

14 *Accounting for Stock-Based Compensation Plans KLA-Tencor accounts for its*
15 *employee stock option and employee stock purchase plans under the recognition*
16 *and measurement principles of APB Opinion No. 25, Accounting for Stock Issued*
17 *to Employees, and related Interpretations. No stock-based employee compensation*
18 *is reflected in net income, as all options granted under those plans had an exercise*
19 *price equal to the market value of the underlying common stock on the date of*
20 *grant. . . . Since KLA-Tencor continues to account for stock-based compensation*
21 *according to APB OPINION NO. 25, its adoption of SFAS No. 148 required the*
22 *Company to provide prominent disclosures about the effects of SFAS 123 on*
23 *reported income and required the Company to disclose these affects in the*
24 *financial statements as well.*

25 127. The September 16, 2003 Form 10-K also falsely represented that the Company's
26 stock options were issued at prices "not less than the fair market value . . . on the date of the grant."

27 *Stock Option and Incentive Plans KLA-Tencor's stock option program is a*
28 *broad-based, long-term retention program that is intended to attract and retain*
qualified management and technical employees ("knowledge employees"), and align
stockholder and employee interests. Under KLA-Tencor's stock option plans,
options generally have a vesting period of five years, are exercisable for a period
not to exceed ten years from the date of issuance and are granted at prices not less
than the fair market value of KLA-Tencor's common stock at the grant date.

The FY 2004 Form 10-K

128. On August 30, 2004, the Company filed its FY 2004 Form 10-K with the SEC signed
by Levy, Schroeder, Kispert, Barnholt, Bingham, Bond, Elkus, Kaufman, Michael Marks, Tompkins

1 and Urbanek. The Form 10-K also attached the Sarbanes-Oxley certifications of Schroeder and
2 Kispert. The FY 2004 Form 10-K was simultaneously distributed to shareholders and the public.
3 The FY 2004 Form 10-K included KLA-Tencor's FY 2004 financial statements which were
4 materially false and misleading and presented in violation of GAAP, due to improper accounting for
5 the backdated stock options. As a result, KLA-Tencor's compensation expense was understated and
6 its net earnings were overstated.

7 129. Further, the August 30, 2004 Form 10-K made the following false representations
8 regarding the way in which options were granted and accounted for:

9 ***Accounting for Stock-Based Compensation Plans*** *KLA-Tencor accounts for its*
10 *employee stock option and employee stock purchase plans under the recognition*
11 *and measurement principles of APB Opinion No. 25, Accounting for Stock Issued*
12 *to Employees, and related Interpretations. No stock-based employee compensation*
13 *is reflected in net income, as all options granted under those plans had an exercise*
14 *price equal to the market value of the underlying common stock on the date of*
15 *grant.*

16 * * *

17 ***Stock Option and Incentive Plans*** *KLA-Tencor's stock option program is a broad-*
18 *based, long-term retention program that is intended to attract and retain qualified*
19 *management and technical employees ("knowledge employees"), and align*
20 *stockholder and employee interests. Under KLA-Tencor's stock option plans, options*
21 *generally have a vesting period of five years, are exercisable for a period not to*
22 *exceed ten years from the date of issuance and are granted at prices not less than*
23 *the fair market value of KLA-Tencor's common stock at the grant date. . . .*

24 * * *

25 ***All stock option grants to officers are approved by the Compensation Committee of***
26 ***the Board of Directors. All members of the Compensation Committee are***
27 ***independent directors, as defined in the applicable rules for issuers traded on the***
28 ***NASDAQ Stock Market.***

The FY 2005 Form 10-K

130. On September 2, 2005, the Company filed its FY 2005 Form 10-K with the SEC.
The FY 2005 Form 10-K was simultaneously distributed to shareholders and the public. The FY
2005 Form 10-K included KLA-Tencor's FY 2005 financial statements which were materially false
and misleading and presented in violation of GAAP, due to its improper accounting for the
backdated stock options. As a result, KLA-Tencor's compensation expense was understated and its
net earnings were overstated.

131. The September 2, 2005 Form 10-K also attached false Sarbanes-Oxley certifications of defendants Schroeder and Kispert, falsely assuring shareholders, and made the following representations:

Our equity incentive program is a broad-based, long-term retention program that is intended to attract and retain qualified management and technical employees ("Knowledge Employees"), and align stockholder and employee interests. The equity incentive program consists of two plans: one under which non-employee directors may be granted options to purchase shares of our stock, and another in which non-employee directors, officers, key employees, consultants and all other employees may be granted options to purchase shares of our stock, restricted stock units and other types of equity awards. *Under our equity incentive program, stock options generally have a vesting period of five years, are exercisable for a period not to exceed ten years from the date of issuance and are generally granted at prices not less than the fair market value of our common stock at the grant date. . . .*

On October 18, 2004, the Company's stockholders approved the 2004 Equity Incentive Plan (the "Omnibus Plan") which provides for the grant of options to purchase shares of the Company's Common Stock, stock appreciation rights, restricted stock, performance shares, performance units and deferred stock units to our employees, consultants and members of our Board of Directors. This new Plan replaces future grants under the 1982 Stock Option Plan and 2000 Nonstatutory Stock Option Plan and supplements the 1998 Outside Director Option Plan. The shareholder approval included the creation of a reserve establishment of 11,000,000 shares of common stock for use under the plan and the ability to transfer up to an additional 1,500,000 shares of forfeited or expired stock under the 1982 Stock Option Plan and the 2000 Nonstatutory Plan.

During the fiscal year ended June 30, 2005, the following actions were taken with regard to the New Equity Incentive Plan: a) a reserve of 11,000,000 shares was established, b) 1,465,853 shares were added to the reserve from the 1982 Stock Option Plan and the 2000 Nonstatutory Plan due to forfeitures or expiration, c) the 1982 Stock Option Plan was terminated; as a result, 12,358,625 shares expired, d) the 2000 Nonstatutory Plan was terminated; and, as a result, 3,447,748 shares expired, e) the 1993 Stock Option Plan was terminated, as a result, 3,500 shares expired and f) The Metrology Stock Option Plan was terminated, as a result 4,238 shares expired.

132. The materially false and misleading FY 1995-2005 Form 10-Ks described above were reviewed, prepared and/or endorsed by the Defendants. The following chart illustrates the Form 10-Ks signed by the Defendants:⁶

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Boehlke*	✓	✓	✓	✓	✓						
Chamberlain	✓	✓	✓	✓	✓						

⁶ Unless otherwise noted, these Defendants served as directors of the Company.

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Tompkins			✓	✓	✓	✓	✓	✓	✓	✓	✓
Elkus			✓	✓	✓	✓	✓	✓	✓	✓	✓
Urbanek			✓	✓		✓	✓	✓	✓	✓	✓
Kispert*						✓	✓	✓	✓	✓	✓
Bingham						✓	✓	✓	✓	✓	✓
Bond						✓	✓	✓	✓	✓	✓
Kaufman									✓	✓	✓
Barnholt	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Schroeder**	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Levy**	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

** = Directors and Officers

* = Officers

The Form 10-Ks also incorporated by reference Form S-8 of December 4, 1998, the 1998 Outside Director Option Plan, Restated 1982 Stock Option Plan (filed March 1997), and the March 11, 1997 Form S-4.

KLA-TENCOR'S FALSE FINANCIAL REPORTING IN VIOLATION OF GAAP

133. As a result of Defendants' improper backdating of stock options, Defendants caused KLA-Tencor to violate GAAP, SEC regulations and IRS rules and regulations.

134. KLA-Tencor financial results for 1996-2006 were included in reports filed with the SEC and in other shareholder reports. In these reports, Defendants represented that KLA-Tencor financial results were presented in a fair manner and in accordance with GAAP.

135. Defendants' representations were false and misleading as to the financial information reported, as such financial information was not prepared in conformity with GAAP, nor was the financial information "a fair presentation" of the Company's financial condition and operations, causing the financial results to be presented in violation of GAAP and SEC rules.

136. GAAP consists of those principles recognized by the accounting profession as the conventions, rules, and procedures necessary to define accepted accounting practice at the particular time. Regulation S-X, to which the Company is subject as a registrant under the Exchange Act, 17

1 C.F.R. §210.4-01(a)(1), provides that financial statements filed with the SEC which are not prepared
2 in compliance with GAAP, are presumed to be misleading and inaccurate.

3 **Violations of GAAP**

4 137. During the Relevant Period, Defendants caused the Company to understate its
5 compensation expense by not properly accounting for its stock options under GAAP and thus
6 overstated the Company's net earnings.

7 138. Under well-settled accounting principles in effect throughout the Relevant Period,
8 KLA-Tencor did not need to record an expense for options granted to employees at the then-current
9 market price ("at the money"). The Company was, however, required to record an expense in its
10 financial statements for any options granted below the then-current market price ("in the money").
11 In order to provide KLA-Tencor executives and employees with far more lucrative "in the money"
12 options, while avoiding having to inform shareholders about millions of dollars incurred by the
13 Company in compensation expenses (and without paying the IRS millions of dollars in employment
14 taxes), Defendants systematically falsified Company records to create the false appearance that
15 options had been granted at the market price on an earlier date.

16 139. Throughout the Relevant Period, KLA-Tencor accounted for stock options using the
17 intrinsic method described in APB Opinion No. 25, Accounting for Stock Issued to Employees.
18 Under APB Opinion No. 25, employers were required to record as an expense on their financial
19 statements the "intrinsic value" of a fixed stock option on its "measurement date." An option that is
20 "in the money" on the measurement date has intrinsic value, and the difference between its exercise
21 price and the quoted market price must be recorded as compensation expense to be recognized over
22 the vesting period of the option. Options that are "at the money" or "out of the money" on the
23 measurement date need not be expensed. Excluding non-employee directors, APB Opinion No. 25
24 required employers to record compensation expenses on options granted to non-employees
25 irrespective of whether they were "in the money" or not on the date of grant.

KLA-Tencor's Forthcoming Restatement Is an Admission of Falsity

140. As detailed above, the fact that KLA-Tencor will need to revise and restate downward its net income is an admission that the financial statements originally issued were false when they were reported and that the misstatements were material.

141. Pursuant to GAAP, as set forth in APB Opinion No. 20, the type of restatements and revisions announced by KLA-Tencor were to correct for material errors in previously issued financial statements. APB Opinion No. 20, ¶¶7-13. The restatement of past financial statements is a disfavored method of recognizing an accounting change as it dilutes confidence by investors in the financial statements, it makes it difficult to compare financial statements and it is often difficult, if not impossible, to generate the numbers when the restatement occurs. *Id.*, ¶14. Thus, GAAP provides that financial statements should only be restated in limited circumstances, *i.e.*, when there is a change in the reporting entity, there is a change in accounting principles used, or to correct an error in previously issued financial statements. KLA-Tencor's restatements and revisions were not due to a change in reporting entity or a change in accounting principle, but rather to errors in previously issued financial statements. Thus, the restatements and revisions were an admission by KLA-Tencor that its previously issued financial results and its public statements regarding those results were false and misleading.

KLA-Tencor's GAAP Violations Were Material

142. KLA-Tencor's false and misleading Relevant Period statements and omissions regarding its accounting were material, particularly in light of SEC guidance on materiality. SEC Staff Accounting Bulletin ("SAB") Topic 1M, Materiality, summarizes GAAP definitions of materiality. Among other items, SAB Topic 1M says: "A matter is 'material' if there is a substantial likelihood that a reasonable person would consider it important." It also stresses that materiality requires qualitative, as well as quantitative, considerations. For example, if a known misstatement would cause a significant market reaction that reaction should be taken into account in determining the materiality of the misstatement.

143. SAB Topic 1M further states:

1 Among the considerations that may well render material a quantitatively small
2 misstatement of a financial statement item are –

3 * * *

- 4 • whether the misstatement masks a change in earnings or other trends
5 • whether the misstatement hides a failure to meet analysts' consensus
6 expectations for the enterprise

7 * * *

- 8 • whether the misstatement concerns a segment or other portion of the
9 registrant's business that has been identified as playing a significant role in the
10 registrant's operations or profitability.

11 144. SAB Topic IM also says that an intentional misstatement of even immaterial items
12 may be illegal and constitute fraudulent financial reporting.

13 145. KLA-Tencor's misstatements, by its own admissions, satisfy these criteria and thus
14 were material from both a quantitative and qualitative perspective.

15 **KLA-Tencor's Financial Statements Violated Fundamental Concepts of GAAP**

16 146. Due to these accounting improprieties, the Company presented its financial results
17 and statements in a manner that violated GAAP, which are described by the following statements:

18 (a) The principle that interim financial reporting should be based upon the same
19 accounting principles and practices used to prepare annual financial statements (APB Opinion No.
20 28, 10);

21 (b) The principle that financial reporting should provide information that is useful
22 to existing and potential investors and creditors and other users in making rational investment, credit
23 and similar decisions (Financial Accounting Standards Board ("FASB") Statement of Concepts No.
24 1, 34);

25 (c) The principle that financial reporting should provide information about the
26 economic resources of an enterprise, the claims to those resources, and the effects of transactions,
27 events and circumstances that change resources and claims to those resources (FASB Statement of
28 Concepts No. 1, 40);

(d) The principle that financial reporting should provide information about how
management of an enterprise has discharged its stewardship responsibility to stockholders for the use

EXHIBIT 3
Part 3 of 3

1 of enterprise resources entrusted to it. To the extent that management offers securities of the
2 enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective
3 investors and to the public in general (FASB Statement of Concepts No. 1, 50);

4 (e) The principle that financial reporting should be reliable in that it represents
5 what it purports to represent (FASB Statement of Concepts No. 2, 58-59);

6 (f) The principle of completeness, which means that nothing material is left out of
7 the information that may be necessary to insure that it validly represents underlying events and
8 conditions (FASB Statement of Concepts No. 2, 79); and

9 (g) The principle that conservatism be used as a prudent reaction to uncertainty to
10 try to ensure that uncertainties and risks inherent in business situations are adequately considered
11 (FASB Statement of Concepts No. 2, 95, 97).

12 147. Further, the undisclosed adverse information concealed by Defendants during the
13 Relevant Period is the type of information which, because of SEC regulations, regulations of the
14 national stock exchanges and customary business practice, is expected by investors and securities
15 analysts to be disclosed, and is known by corporate officials and their legal and financial advisors to
16 be the type of information which is expected to be and must be disclosed.

17 **Violations of the SEC Regulations**

18 148. During the Relevant Period, Defendants caused KLA-Tencor to violate SEC
19 regulations by failing to disclose that the Company's senior executives had been granted backdated
20 stock options.

21 149. Under SEC Regulations, Item 8 of Form 14-A and Item 11 of Form 10-K, an issuer
22 must furnish information required by Item 402 of Regulation S-K (17 C.F.R. §229.402). Item
23 402(b) and (c) require a company to provide both a summary compensation table and an option/SAR
24 ("stock appreciation right") grants table identifying the compensation of the named executive
25 officers – the Company's CEO and its next four most highly paid executives. Item 402 requires
26 particularized disclosures involving a company's stock option grants in the last fiscal year. In the
27 summary compensation table, the issuer must identify in a column "other annual compensation"
28 received by the named executives that is not properly categorized as salary or bonus, including any

1 “[a]bove-market or preferential earnings on restricted stock, options, SARs or deferred
2 compensation” paid to the officer during the period. Item 402(b)(2)(iii)(C)(2). In the option grants
3 table, the issuer must identify in a column “[t]he per-share exercise or base price of the options
4 If such exercise or base price is less than the market price of the underlying security on the date of
5 grant, a separate, adjoining column shall be added showing market price on the date of grant.” Item
6 402(c)(2)(iv).

7 150. Defendants caused KLA-Tencor to violate SEC Regulations by failing to disclose that
8 the Company’s named executive officers had been granted options with exercise prices below the
9 market value on the date the Board or Compensation Committee approved the grant.

10 **Violations of IRS Rules and Regulations**

11 151. During the Relevant Period, Defendants further caused KLA-Tencor to violate IRS
12 rules and regulations due to its improper accounting for the backdated stock options. As a result, the
13 Company’s tax liabilities were understated exposing KLA-Tencor to potential amounts owed for
14 back taxes, penalties and interest to the IRS for improperly reporting compensation.

15 152. Defendants caused the Company to violate IRS Code §162(m) which generally limits
16 a publicly traded company’s tax deductions for compensation paid to each of its named executive
17 officers to \$1 million unless the pay is determined to be “performance-based.” In order for
18 compensation to be performance-based, the Compensation Committee must have set pre-established
19 and objective performance goals. The goals must then be approved by the shareholders.
20 Section 162(m) defines stock options as performance-based, provided they are issued at an exercise
21 price that is no less than the fair market value of the stock on the date of the grant. Accordingly,
22 properly issued stock options do not have to be taken into account in calculating whether an
23 executive’s compensation has exceeded the \$1 million compensation cap.

24 153. Section 162(m), known as the \$1 million rule, was enacted in 1993 in order to tie top
25 executives’ soaring pay packages more closely to a company’s performance. This change in the tax
26 law turned compensation practices for a company’s top executives away from straight salary-based
27 compensation to performance-based compensation, including stock options. According to former
28

1 SEC Chairman Harvey Pitt: "What [§162(m)] did was create incentives to find other forms of
2 compensation so people could get over the \$1 million threshold without running afoul of the code."

3 154. Defendants caused KLA-Tencor to violate IRS Code §162(m) by providing
4 backdated options to the Company's named executive officers, which were granted with exercise
5 prices that were less than the fair market value of the stock on the date of the grant. As a result, all
6 of the income resulting from the exercise of the options must be included for purposes of calculating
7 whether the named executive's compensation exceeds the \$1 million cap for federal tax purposes.

8 155. Defendants further caused the Company to violate IRS rules and regulations in order
9 to avoid having to withhold income and FICA ("Federal Insurance Contributions Act") tax from its
10 executives and employees upon the exercise of KLA-Tencor's stock options by improperly
11 accounting for its Non-Qualified Stock Options ("NQSOs") as Incentive Stock Options ("ISOs").

12 156. ISOs are a form of equity compensation that may be provided to a company's
13 employees. ISOs are required to be granted at an exercise price that is no less than the fair market
14 value of the stock on the date of the grant, and are entitled to preferential tax treatment as they are
15 not subject to income tax upon exercise of the options but only upon sale of the stock (except for the
16 possible imposition of alternative minimum tax on the option spread at the time of exercise). Stock
17 options that do not qualify as ISOs are considered to be NQSOs. NQSOs are not entitled to
18 preferential treatment as they are subject to income tax and FICA withholding upon exercise. As a
19 result, a company that fails to withhold income tax and/or FICA upon the exercise of NQSOs by its
20 employees would be liable for the amount of the income tax and FICA that the company failed to
21 withhold upon exercise of the options, in addition to interest and penalties.

22 157. By improperly treating its backdated options as ISOs, Defendants failed to provide
23 proper income tax and FICA withholdings upon the exercise of its options by its executives and
24 employees in violation of IRS rules and regulations.

25 **THE COMPANY REVELATIONS AND ADMISSIONS OF**
26 **STOCK OPTION BACKDATING**

27 158. The FY 1995-2005 Proxy Statements concealed Defendants' option backdating
28 scheme. Thus, the Company's shareholders remained unaware of Defendants' wrongdoing when

1 voting on proxy proposals between 1994 and 2005. In fact, it was not until *The Wall Street Journal*
2 article that shareholders learned that the Proxy Statements which they had relied upon for nearly a
3 decade were false and misleading.

4 159. On May 22, 2006, KLA-Tencor's stock dropped when it was mentioned in *The Wall*
5 *Street Journal* article on companies at risk for being involved in the backdating scandal.

6 160. On May 24, 2006, the Company confirmed that it was a target of DOJ investigations
7 and announced that it had received subpoenas from the U.S. Attorneys' Offices in New York and
8 California. That same day the Company announced the formation of a Special Committee to
9 investigate stock option practices. The Form 8-K provided:

10 KLA-Tencor Corporation announced today that its Board of Directors has appointed
11 a Special Committee of independent directors to conduct an internal investigation
12 relating to past stock option grants, the timing of such grants and related accounting
13 and documentation. The Special Committee will be assisted by outside legal counsel
14 and accounting experts. KLA-Tencor also said that it has received subpoenas from
15 the U.S. Attorney's Offices for the Eastern District of New York and Northern
16 District of California requesting information relating to its past stock option grants.
17 KLA-Tencor said that it will cooperate fully with any government or regulatory
18 investigation into these matters. KLA-Tencor further disclosed that on May 22,
19 2006, it was served with a complaint relating to a lawsuit filed in the United States
20 District Court for the Northern District of California filed by the Theodore R.
21 Kornreich Revocable Trust, derivatively on behalf of KLA-Tencor.

22 161. Additionally, as a result of the sharp decline in KLA-Tencor's stock due to its
23 involvement in the ongoing option granting scandal, KLA-Tencor has been forced to renegotiate its
24 deal to acquire ADE. Initially, on February 23, 2006, KLA-Tencor announced that it had entered
25 into an agreement with ADE to acquire ADE in a stock-for-stock transaction valued at
26 approximately \$488 million. Under the agreement, KLA-Tencor would issue 0.64 share of KLA-
27 Tencor per one share of ADE. This calculation was based upon the closing price of KLA-Tencor
28 stock for February 22, 2006 of \$51.73. Due to the recent sharp decline of the value of KLA-
Tencor's stock, KLA-Tencor was forced to change the terms of its agreement with ADE into an all-
cash transaction instead of a stock-for-stock transaction. On May 26, 2006, KLA-Tencor announced
that it had amended its agreement with ADE from a stock-for-stock transaction to an all-cash
transaction and that it had agreed to pay \$32.50 in cash per share of ADE stock in a transaction

1 valued at approximately \$478 million. KLA-Tencor's stock closed at \$40.62 per share on May 26,
2 2006 – a 21.5% decline from February 22, 2006.

3 162. On September 28, 2006, the Company announced an impending restatement of
4 publicly reported financial statements due to the backdating/misdating of stock options:

5 **KLA-Tencor Will Restate Financial Statements Related to Stock Options**

6 *SAN JOSE, Calif., September 28, 2006 – KLA-Tencor Corporation (NASDAQ:
7 KLAC) today announced that it will restate previously issued financial statements
8 to correct the Company's past accounting for stock options. Based on a report
9 received from a Special Committee of the Board of Directors, the Board concluded
10 that incorrect measurement dates for certain stock option grants were used for
11 financial accounting purposes, principally during the periods July 1, 1997 through
12 June 30, 2002. As a result, the Company will be required to record non-cash
13 charges for compensation expenses relating to those past stock option grants.*

14 The Company has not determined the exact amount of such charges, the resulting tax
15 and accounting impact, or which specific reporting periods may require restatement.
16 Accordingly, the Company is filing a Form 8-K today stating that the financial
17 statements and all earnings and press releases and similar communications issued
18 by the Company relating to periods beginning on or after July 1, 1997, should no
19 longer be relied upon. KLA-Tencor intends to file its restated financial results and
20 Annual Report on Form 10-K as quickly as practicable.

21 KLA-Tencor does not anticipate that the restatement will have any impact on the
22 Company's historical revenues. Any stock-based compensation charges incurred as
23 a result of the restatement would have the effect of decreasing reported income or
24 increasing reported loss from operations, and decreasing reported net income or
25 increasing reported net loss, and decreasing reported retained earnings amounts
26 contained in the Company's historical financial statements for the affected
27 periods.

28 163. Thereafter, on October 16, 2006, the Company announced that it was immediately
terminating all relationships with Schroeder and that it fired its General Counsel, defendant Nichols.
On October 17, 2006, the Company announced the retirement of defendant Levy along with the fact
that Levy received backdated options and that his options would be repriced.

164. Finally, as discussed above in ¶¶43-47, on January 29, 2007, the Company filed its
Form 10-K for the period ending June 30, 2006 detailing restated financials between 1994-2006 and
the specific findings of the Special Committee.

25 **DERIVATIVE DEMAND FUTILITY ALLEGATIONS**

26 165. At the time the first derivative action was commenced, the KLA-Tencor Board
27 consisted of nine directors: Levy, Barnholt, Wallace, Kaufman, Urbanek, Bond, Tompkins, Wang
28

1 and Bingham. Eight of these directors are incapable of independently and disinterestedly
2 considering a demand to commence and vigorously prosecute the derivative actions:

3 (a) Defendants Levy, Tompkins and Wallace are incapable because they received
4 backdated stock options, and they are directly interested in the improperly backdated stock option
5 grants complained of herein, as recipients thereof. These defendants also sold hundreds of thousands
6 of shares of KLA-Tencor stock for millions of dollars in insider trading proceeds (*see supra*, ¶27);

7 (b) Bond, Barnholt and Urbanek are incapable because as members of the
8 Compensation Committee, each directly participated in and approved the improper backdating of
9 stock options, as alleged herein or misrepresented and falsely assured the Company shareholders that
10 KLA-Tencor stock options were issued at fair market value on the date of the grant. They indeed
11 were the Board members who purported but failed to “*review[] . . . the Company’s executive*
12 *compensation policy and administer[] the Company’s . . . equity benefit plan*” under which stock
13 options were granted. Moreover, by colluding with Defendants and others, as alleged herein, Bond,
14 Barnholt and Urbanek have demonstrated that they are unable and unwilling to act independently of
15 Defendants; and

16 (c) All of the members of the Audit Committee, including Bingham, Bond and
17 Kaufman are incapable because as veteran members of the Audit Committee, they directly
18 participated in and approved the Company’s knowing violations of GAAP and IRS Code §162(m),
19 as alleged herein. Defendant Bingham was represented to shareholders as being a “financial expert,”
20 and has been Chairman of the Audit Committee for the last five years. Moreover, by colluding with
21 Defendants and others, as alleged herein, Bingham, Bond and Kaufman have demonstrated that they
22 are unable and unwilling to act independently of Defendants.

23 166. The instant Complaint includes federal securities claims brought under the Exchange
24 Act for violations of §10(b) and Rule 10b-5 promulgated thereunder, and for violations of proxy
25 disclosure requirements under §14(a) of the Exchange Act and Cal. Corp. Code §25402. Under both
26 federal and Delaware law, proxy disclosure claims are not subject to the pre-suit demand
27 requirement because imposing such a requirement would enable a Board to override federal and
28

1 Delaware policy requiring full disclosure in all Proxy Statements. Indeed, the business judgment
2 rule does not apply to proxy disclosure claims.

3 167. In relation to plaintiffs' other claims, prior demand upon a Board of Directors is
4 excused if plaintiffs allege facts that, if accepted as true, raise a reasonable doubt that: (a) the
5 challenged transaction was the product of a valid business judgment; or (b) a majority of the
6 directors are disinterested and independent. If either prong of this test is satisfied, demand is
7 excused.

8 168. By reason of their corporate positions and their ability to control the business and
9 corporate affairs of KLA-Tencor at all relevant times, the directors of KLA-Tencor owed KLA-
10 Tencor and its stockholders fiduciary duties of candor, fidelity, trust, and loyalty, and are and were
11 required to use their ability to control KLA-Tencor in a fair, just and equitable manner, as well as to
12 act in furtherance of the best interests of KLA-Tencor and its stockholders. In addition, the directors
13 owed KLA-Tencor the fiduciary duty to exercise due care and diligence in the management and
14 administration of the affairs of KLA-Tencor and in the use and prevention of its property and assets.
15 In violation of their fiduciary duties, Defendants approved of and/or caused KLA-Tencor to issue
16 illegally backdated stock options to many of its employees for a period beginning in at least 1995
17 and continuing through 2005.

18 **A Majority of KLA-Tencor's Directors Are Not Independent and Disinterested**

19 169. A majority of KLA-Tencor's Board are interested and/or incapable of independently
20 evaluating the claims in this lawsuit. Of the nine members of the Board at the time this action was
21 filed, a majority of them have significant conflicts which would make a demand on the Board futile
22 and useless. In particular:

23 (a) Defendant Levy founded KLA Instruments in 1976 and was both Chairman of
24 the Board and CEO of the Company. Because of these dual roles, Levy is incapable of exercising
25 independent judgment regarding this action. Levy was Chair of KLA-Tencor's Nominating and
26 Governance Committee from 1997 and continued to serve on the Committee until October 17, 2006.
27 As the Chairman and/or member of the Nominating and Governance Committee, Levy had a
28 responsibility to oversee the Company's nomination of directors and developing and leading

1 corporate governance policies and principles at the Company. As former Chairman and CEO of
2 KLA-Tencor, Levy stands to earn millions of dollars in retirement and severance compensation, all
3 of which must be approved by the current members of the Compensation Committee. Though the
4 Company has repriced Levy's backdated options, it has not indicated that it will recover bonuses and
5 insider trading proceeds obtained in part by falsifying the Company's financial statements. Indeed,
6 through the falsification of the Company's financial statements and, based upon his knowledge of
7 material non-public information regarding the Company, Levy has made over **\$111 million** through
8 his sales of Company stock. In addition, Levy is a director and a named defendant in *In re Juniper*
9 *Derivative Actions*, No. 5:06-cv-03396-JW, wherein he is alleged to have backdated stock options.
10 Juniper admitted on December 21, 2006 that it will restate **\$900 million** in compensation expenses
11 due to improperly backdated stock options between 1997 and 2003. Levy grossly abandoned his
12 fiduciary duties and betrayed KLA-Tencor and its shareholders by knowingly approving and/or
13 directing that Company directors and officers manipulate the grant date of stock options.
14 Accordingly, Levy is incapable of independently and disinterestedly considering a demand to
15 commence and vigorously prosecute the above-captioned action against Defendants;

16 (b) Defendant Levy himself received backdated/misdated option grants. Further,
17 Levy faces a significant likelihood of criminal and/or civil prosecution from his participation in, and
18 direction of, this fraudulent and illegal scheme. There can be no doubt that these conflicts make
19 Levy interested in these transactions, and completely incapable of exercising independent judgment
20 regarding this lawsuit;

21 (c) Defendant Bond has served as a director of the Company since 1997.
22 Between 2000 and 2005, Bond was a member of the Compensation Committee responsible for
23 reviewing and making recommendations to the Board concerning stock option issuances for certain
24 executive officers and certain employees. During the Relevant Period, Bond represented that the
25 Compensation Committee reviewed and recommended individual options grants to the Board, taking
26 into account the officer's scope of responsibility and specific assignments, strategic and operational
27 goals applicable to the officer, anticipated performance requirements and contributions of the officer,
28 and the number of options previously granted to the officer. Moreover, Bond falsely confirmed in

1 Compensation Committee reports that stock option grants were made at the fair market value on the
2 date of the grant. These statements and assertions were knowingly false because Bond either: (i)
3 knew that KLA-Tencor granted options inconsistent with publicly disclosed policies or without any
4 approval or review by the Compensation Committee or the Board; or (ii) knew that KLA-Tencor's
5 Compensation Committee had illegally backdated option grants to increase their value to the
6 grantees contrary to the requirements of KLA-Tencor's Stock Option Plans. Accordingly, Bond
7 ignored his fiduciary duties to KLA-Tencor, and deliberately or recklessly materially misrepresented
8 the level of review and oversight that the Compensation Committee provided. Further, Bond also
9 has served on KLA-Tencor's Audit Committee from at least 2003 to 2005 and represented that the
10 Audit Committee provided oversight regarding the integrity of the Company's financial statements,
11 the Company's compliance with legal and regulatory requirements, and the Company's internal
12 accounting and financial controls. As a member of the Audit Committee, Bond had a special duty to
13 know and understand the material information regarding the stock option grants as it affected the
14 Company's financial statements as provided for in the Audit Committee's charter. Accordingly,
15 Bond knew or should have known that KLA-Tencor's financial statements were inaccurate and that
16 certain stock option grants were improperly accounted for. Nonetheless, Bond permitted and/or
17 condoned the unlawful practices described herein, including preparing false reports in the
18 Company's Proxy Statements and annual reports and interim financial reports which did not disclose
19 this egregious practice. Bond knew or deliberately disregarded that the Company had failed to
20 disclose material weaknesses in its financial statements and internal controls and specifically
21 misrepresented the Company's compliance with GAAP and APB Opinion No. 25. Because Bond
22 either knew that KLA-Tencor had (a) backdated options without reporting the cost of such options in
23 KLA-Tencor's Proxy Statements or financial filings; or (b) allowed the backdating of options to
24 occur unchecked by failing to exercise adequate oversight over KLA-Tencor's financial reporting,
25 Bond ignored his fiduciary duties to KLA-Tencor, and deliberately misrepresented the level of
26 review and oversight that the Audit Committee provided.

27 (d) Because of Bond's lack of due care with respect to his duties on the Audit
28 Committee, KLA-Tencor has suffered tremendous damages from this scandal. Bond either knew

1 that backdating was occurring on a systematic basis, or allowed for the waste of millions of dollars
2 of corporate assets by failing to provide the necessary oversight that could have prevented the
3 widespread manipulation of KLA-Tencor's Stock Option Plans. As a result, Bond could not
4 objectively consider a demand in this matter.

5 (e) Defendant Kaufman has been a director of KLA-Tencor since 2002. Kaufman
6 has served on KLA-Tencor's Audit Committee since 2003. During the Relevant Period, Kaufman
7 represented that the Audit Committee provided oversight regarding the integrity of the Company's
8 financial statements, the Company's compliance with legal and regulatory requirements, and the
9 Company's internal accounting and financial controls. As a member of the Audit Committee,
10 Kaufman had a special duty to know and understand the material information regarding the stock
11 option grants as it affected the Company's financial statements as provided for in the Audit
12 Committee's charter. Accordingly, Kaufman knew or should have known that KLA-Tencor's
13 financial statements were inaccurate and that certain stock option grants were improper.
14 Nonetheless, Kaufman permitted and/or condoned the unlawful practices described herein, including
15 preparing false reports in the Company's Proxy Statements and annual reports and interim financial
16 reports which did not disclose this egregious practice. Accordingly, Kaufman knew or should have
17 known that KLA-Tencor's financial statements were false and certain stock options granted were
18 improperly accounted for. Kaufman knew or deliberately disregarded that the Company had failed
19 to disclose material weaknesses in its financial statements and internal controls and specifically
20 misrepresented the Company's compliance with APB Opinion No. 25 and that KLA-Tencor had
21 backdated options without reporting the cost of such options in KLA-Tencor's Proxy Statements or
22 financial filings. Alternatively, Kaufman allowed the backdating of options to occur unchecked by
23 failing to exercise adequate oversight over KLA-Tencor's financial reporting. In either respect,
24 Kaufman ignored his fiduciary duties to KLA-Tencor, and deliberately misrepresented the level of
25 review and oversight that the Audit Committee provided.

26 (f) Because of Kaufman's lack of due care with respect to his duties on the Audit
27 Committee, KLA-Tencor has suffered tremendous damages from this scandal. Kaufman either knew
28 that backdating was occurring on a systematic basis, or allowed for the waste of millions of dollars

1 of corporate assets by failing to provide the necessary oversight that could have prevented the blatant
2 and widespread manipulation of KLA-Tencor's Stock Option Plans. As a result Kaufman could not
3 objectively consider a demand in this matter;

4 (g) Defendant Barnholt has been a director of KLA-Tencor since 2001. Barnholt
5 has served on KLA-Tencor's Compensation Committee since 2003. During the Relevant Period,
6 Barnholt represented that the Compensation Committee reviewed option grants to KLA-Tencor
7 officers, and that the Compensation Committee approved and made recommendations to the Board
8 concerning incentive compensation for executive officers and employees. These statements and
9 assertions were false because Barnholt either knew that KLA-Tencor had granted options
10 inconsistent with the Stock Option Plans and/or knew that the KLA-Tencor Compensation
11 Committee or the Board was illegally backdating option grants to increase their value to the grantees
12 contrary to the requirements of KLA-Tencor's Stock Option Plans. In either respect, Barnholt
13 ignored fiduciary duties to KLA-Tencor and deliberately misrepresented the level of review and
14 oversight that the Compensation Committee provided. Barnholt cannot be independent and
15 disinterested in litigation that so directly implicates his abdication of his fiduciary duties. Because of
16 Barnholt's lack of due care with respect to his duties on the Compensation Committee, KLA-Tencor
17 has suffered tremendous damages from this scandal. Barnholt either knew that backdating was
18 occurring on a systematic basis, or allowed for the waste of millions of dollars of corporate assets by
19 failing to provide the necessary oversight that could have prevented the blatant and widespread
20 manipulation of KLA-Tencor's Stock Option Plans;

21 (h) Defendant Bingham has been a director since 1999 and has served on KLA-
22 Tencor's Audit Committee from at least 2001 through 2005. During the Relevant Period, Bingham
23 represented that the Audit Committee provided oversight as provided in the Audit Committee
24 Charter regarding the integrity of the Company's financial statements, the Company's compliance
25 with legal and regulatory requirements, and the Company's internal accounting and financial
26 controls. As a member of the Audit Committee, Bingham had a special duty to know and understand
27 the material information regarding the stock option grants as it affected the Company's financial
28 statements as provided for in the Audit Committee's charter. Accordingly, Bingham knew or should

1 have known that KLA-Tencor's financial statements were inaccurate and that certain stock option
2 grants were improperly accounted for. Nonetheless, Bingham permitted and/or condoned the
3 unlawful practices described herein, including preparing false reports in the Company's Proxy
4 Statements and annual reports and interim financial reports which did not disclose this egregious
5 practice. These statements and assertions were false because Bingham either: (i) knew that KLA –
6 Tencor had in fact awarded backdated options without reporting the cost of such options in KLA-
7 Tencor's Proxy Statements or financial filings; or (ii) allowed the backdating of options to occur
8 unchecked by failing to exercise adequate oversight over KLA-Tencor's financial reporting. In
9 either respect, Bingham ignored his fiduciary duties to KLA-Tencor, and deliberately misrepresented
10 the level of review and oversight that the Audit Committee provided;

11 (i) Defendant Wallace has been a director of KLA-Tencor since November 16,
12 2005. Defendant Wallace served as the Company's President and COO in 2005 and 2006. Further,
13 during the Relevant Period, apart from receiving backdated stock options, Wallace sold 292,449
14 shares of KLA-Tencor stock for insider trading proceeds of \$15.5 million.

15 (j) Defendant Urbanek has been a director of KLA-Tencor since 1997 and has
16 served on KLA-Tencor's Compensation Committee since 1997. During the Relevant Period
17 Urbanek represented that the Compensation Committee reviewed option grants to KLA-Tencor
18 officers, and made recommendations to the Board concerning incentive compensation for executive
19 officers and employees. These statements and assertions were false because Urbanek either: (i)
20 knew that KLA-Tencor had issued stock options inconsistent with the Stock Option Plans which
21 provided that stock options were granted at fair market value on the grant date; or (ii) knew that the
22 Company's Board was backdating option grants to increase their value to the grantees contrary to the
23 requirements of KLA-Tencor's Stock Option Plans. In either respect, she ignored her fiduciary
24 duties to KLA-Tencor, and deliberately or recklessly misrepresented the level of review and
25 oversight that the Compensation Committee provided. Urbanek cannot be independent and
26 disinterested in litigation that so directly implicates her abdication of her fiduciary duties. Because
27 of Urbanek's lack of due care with respect to her duties on the Compensation Committee, KLA-
28 Tencor has suffered tremendous damages from this scandal. Urbanek either knew that backdating

1 was occurring on a systematic basis, or allowed for the waste of millions of dollars of corporate
2 assets by failing to provide the necessary oversight that could have prevented the blatant and
3 widespread manipulation of KLA-Tencor's Stock Option Plans.

4 (k) Defendant Tompkins has served as a director since 1997 and served as
5 Chairman of the Board from July 1997 to June 1999. He also served as CEO of the Company from
6 May 1997 to July 1998. He was a member of KLA-Tencor's Nominating and Governance
7 Committee in 1998, and as a member, he had a duty to oversee the Company's nomination of
8 directors, and a duty to develop corporate governance policies and lead with respect to those policies.
9 Because of Tompkins' positions, he knew the adverse non-public information about the business of
10 the Company, as well as its finances, markets and present and future business prospects, via access
11 to internal corporate documents, conversations and connections with other corporate officers and
12 employees, attendance at Board meetings and committees thereof and via reports and other
13 information provided to him in connection therewith. Tompkins received backdated/misdated
14 options and based on his knowledge of material non-public information regarding the Company,
15 Tompkins violated Cal. Corp. Code §§25402 and 25502.5 by selling shares of KLA-Tencor stock for
16 proceeds of \$31.5 million during the Relevant Period.

17 **Options Backdating Is Not the Product of Business Judgment Because It Is *Ultra Vires*,
18 Illegal, and Contrary to the Stated Purpose of the Stock Option Plans**

19 170. The practice of granting illegal and backdated stock options is not protected by the
20 business judgment rule because it is *ultra vires*. The various stock option plans under which these
21 options were purportedly given, and the Proxy Statements disclosing grants to senior executives and
22 directors during this time period, all represented and required that the stock grants in question be
23 priced based on the fair market value of KLA-Tencor stock on the day of the grant.

24 171. However, contrary to this limited authority given to the Board by KLA-Tencor's
25 Stock Option Plans, and contrary to KLA-Tencor's representations in the proxy filings, by KLA-
26 Tencor's own admission, *most* of KLA-Tencor's option grants between 1997 and 2002 were priced
27 at a date earlier than the actual date on which they were granted. Further, such conduct caused the
28 Company's financial statements for nearly a decade to be false and misleading. Because granting

1 options using manipulated grant dates to lower the strike price of the options is not permitted by the
2 Stock Option Plans, this conduct is *ultra vires* and void on its face. *Ultra vires* acts are not protected
3 by the business judgment rule, and thus demand is excused.

4 172. Additionally, Defendants' conduct caused KLA-Tencor to issue materially false
5 financial reports and Proxy Statements for the entirety of the period in question, in violation of
6 numerous provisions of the federal securities laws. Each Defendant violated §10(b) and Rule 10b-5
7 of the Exchange Act by participating in this fraudulent scheme. Each director violated §14(a) of the
8 Exchange Act by issuing false and misleading Proxy Statements from 1995 to 2005. And each
9 director violated §20(a) of the Exchange Act by being controlling persons of KLA-Tencor and
10 engaging in the purchase and/or sale of KLA-Tencor stock while in the possession of material non-
11 public information regarding KLA-Tencor's backdating scheme. Demand is excused because these
12 are illegal acts that are not protected by the business judgment rule.

13 173. Even if stock option backdating was not illegal, *ultra vires*, and void, there would be
14 no plausible argument that backdating stock options was a valid exercise of business judgment. As
15 represented in KLA-Tencor's Proxy Statements, the stated purpose of KLA-Tencor's Stock Option
16 Plans is to encourage the productivity of KLA-Tencor employees by providing compensation that is
17 proportional to gains in KLA-Tencor's stock price. However, by granting options with backdated
18 strike prices, Defendants undermined the purpose of the Stock Option Plans which was to incentivize
19 grant recipients to commit to the advancement of the Company's stock price thereby aligning the
20 interest of the employees with that of the Company. In effect, this practice was nothing more than
21 secret handouts to executives and employees at the expense of unsuspecting shareholders and the
22 market at large.

23 174. Defendants could have achieved the stated purpose of attracting and retaining
24 qualified employees by granting those employees additional options under their incentive plans, or
25 by granting options at a price less than the fair market value on the day of the grant and simply
26 disclosing and expensing these grants. Instead, Defendants intentionally concealed these known
27 grants and illegally reported these grants in their financial disclosures to improve their bottom line.

28

1 175. Further, the practice of backdating stock options could not have been a valid exercise
2 of business judgment because it has subjected KLA-Tencor to potentially massive liability. KLA-
3 Tencor has disclosed that it will have to restate financial statements for several past periods. The
4 Company's practices are being investigated by the SEC and DOJ. The Company will likely suffer
5 tax liabilities for the additional compensation they will have to expense, and they have tarnished
6 their reputation in the investment community through this deliberate and calculated conduct. In
7 addition, the Company has already had to pay millions of dollars to keep their creditors at bay until
8 they are able to file their most recent Form 10-Q.

9 176. In particular, demand would be a futile and useless act for the following reasons:

10 (a) A majority of the current KLA-Tencor Board participated in or approved
11 many of the acts and omissions or were on notice of and/or recklessly disregarded the wrongs
12 complained of herein;

13 (b) KLA-Tencor's Board ultimately had to approve all option grants. Some of the
14 directors themselves received options by virtue of their employment at KLA-Tencor that were likely
15 backdated;

16 (c) Regardless of whether any individual director received a backdated grant, all
17 of KLA-Tencor's directors benefited from the option backdating because it allowed KLA-Tencor to
18 overstate its profits and understate its compensation expenses for the years in question. Thus, every
19 time the directors exercised KLA-Tencor stock options—backdated or not—they were doing so with
20 knowledge that KLA-Tencor's stock price was illegally overstated because of their approval of, or
21 acquiescence to, these fraudulent practices. They have thus benefited from the wrongdoing herein
22 alleged, and are incapable of exercising independent objective judgment in deciding whether to bring
23 this action;

24 (d) The acts complained of herein constitute violations of law and breaches of the
25 fiduciary duties owed by KLA-Tencor's Board, and these acts are incapable of ratification;

26 (e) In order to bring this action for breaching their fiduciary duties, the members
27 of the KLA-Tencor Board would have been required to sue themselves and/or their fellow directors
28 and allies in the top ranks of the Company, who are their good friends and with whom they have

1 entangling financial alliances, interests and dependencies, which they would not do. Therefore,
2 Defendants would not be able to vigorously prosecute any such action;

3 (f) The composition of KLA-Tencor's Board is designed to (and does) make
4 them dependent on and deferential to the top officers of the Company and Chairman of the Board
5 who, as a practical matter, control and dominate the process by which directors are selected for
6 nomination or renomination to the Board;

7 (g) If KLA-Tencor's current and past officers and directors are protected against
8 personal liability for their acts of mismanagement, waste and breach of fiduciary duty alleged in this
9 Complaint by directors' and officers' liability insurance, they caused the Company to purchase that
10 insurance for their protection with corporate funds, *i.e.*, monies belonging to the stockholders of
11 KLA-Tencor. However, due to certain changes in the language of directors' and officers' liability
12 insurance policies in the past several years, the directors' and officers' liability insurance policies
13 covering Defendants in this case contain provisions which eliminate coverage for any action brought
14 directly by KLA-Tencor against these Defendants, known as, *inter alia*, the "insured versus insured
15 exclusion." As a result, if these directors were to sue themselves or certain of the officers of KLA-
16 Tencor, there would be no directors' and officers' insurance protection and thus, this is a further
17 reason why they would not bring such a suit. On the other hand, if the suit is brought derivatively, as
18 this action is brought, such insurance coverage exists and will provide a basis for the Company to
19 effectuate a recovery. If there is no directors' and officers' liability insurance at all, then Defendants
20 will not cause KLA-Tencor to sue them, since they will face a large uninsured liability.

21 177. Because plaintiffs can show a reasonable doubt that a majority of KLA-Tencor's
22 directors at the time of suit were disinterested and independent at the time of suit, and because the
23 challenged transaction was clearly not the product of a valid business judgment, a demand upon
24 KLA-Tencor's Board would be futile and is excused.

25 178. Plaintiffs have not made any demand on shareholders of KLA-Tencor to institute this
26 action since such demand would be a futile and useless act for the following reasons:

27 (a) KLA-Tencor is a publicly traded Company with approximately 199 million
28 shares outstanding, and thousands of shareholders;

1 (b) Making a demand on such a number of shareholders would be impossible for
2 plaintiffs who have no way of finding out the names, addresses or phone numbers of shareholders;
3 and

4 (c) Making a demand on all shareholders would force plaintiffs to incur huge
5 expenses, assuming all shareholders could be individually identified.

6 **TOLLING OF THE STATUTE OF LIMITATIONS**

7 179. The Counts alleged herein are timely. As an initial matter, Defendants wrongfully
8 concealed their manipulation of the stock option plans, through strategic timing and fraudulent
9 backdating, by issuing false and misleading Proxy Statements, by falsely reassuring KLA-Tencor's
10 public investors that KLA-Tencor's option grants were being administered by a committee of
11 independent directors, and by failing to disclose that backdated options were, in fact, actually issued
12 on dates other than those disclosed, and that strategically timed option grants were issued based on
13 the manipulation of insider information that ensured that the true fair market value of the Company's
14 stock was, in fact, higher than the publicly traded price on the date of the option grant.

15 180. KLA-Tencor's public investors had no reason to know of the Defendants' breach of
16 their fiduciary duties until May 2006, when *The Wall Street Journal* published its article detailing
17 the option practices of KLA-Tencor and other companies.

18 181. Finally, as fiduciaries of KLA-Tencor and its public shareholders, the Defendants
19 cannot rely on any limitations defense where they withheld from KLA-Tencor's public shareholders
20 the facts that give rise to the claims asserted herein, *i.e.*, that the KLA-Tencor Board had abdicated
21 its fiduciary responsibilities to oversee the Company's executive compensation practices, and that
22 the option grant dates had been manipulated to maximize the profit for the grant recipients and,
23 accordingly, to maximize the costs for the Company.

24 **COUNT I**

25 **Violations of Section 10(b) and Rule 10b-5 of the Exchange Act** 26 **Against All Defendants**

27 182. Plaintiffs incorporate by reference and reallege each and every allegation set forth
28 above, as though fully set forth herein.

1 183. Throughout the Relevant Period, Defendants individually and in concert, directly and
2 indirectly, by the use and means of instrumentalities of interstate commerce and/or of the mails,
3 engaged and participated in a continuous course of conduct designed to divert hundreds of millions
4 of dollars to Defendants via improper option grants.

5 184. Defendants employed devices, schemes and artifices to defraud while in possession of
6 material, adverse non-public information and engaged in acts, practices and a course of conduct that
7 included the making of, or participation in the making of, untrue and/or misleading statements of
8 material facts and/or omitting to state material facts necessary in order to make the statements made
9 about KLA-Tencor not misleading.

10 185. Defendants, as top executive officers and directors of the Company, are liable as
11 direct participants in the wrongs complained of herein. Through their positions of control and
12 authority as officers of the Company, each of the Defendants was able to and did control the conduct
13 complained of herein and the content of the public statements disseminated by KLA-Tencor.

14 186. Defendants acted with scienter throughout the Relevant Period, in that they either had
15 actual knowledge of the misrepresentations and/or omissions of material facts set forth herein, or
16 acted with reckless disregard for the truth in that they failed to ascertain and to disclose the true
17 facts, even though such facts were available to them. Defendants were among the senior
18 management of the Company, and were therefore directly responsible for the false and misleading
19 statements and/or omissions disseminated to the public through press releases, news reports and
20 filings with the SEC.

21 187. Each of the Defendants participated in a scheme to defraud with the purpose and
22 effect of defrauding KLA-Tencor.

23 188. By virtue of the foregoing, Defendants have violated §10(b) of the Exchange Act, and
24 Rule 10b-5 promulgated thereunder.

25
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28

COUNT II**Violations of Section 14(a) of the Exchange Act Against
All Defendants**

189. Plaintiffs incorporate by reference and reallege each and every allegation set forth above, as though fully set forth herein.

190. Rule 14a-9, promulgated pursuant to §14(a) of the Exchange Act, provides that no Proxy Statement shall contain “any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading.” 17 C.F.R. §240.14a-9.

191. The FY 1995-2005 Proxy Statements violated §14(a) and Rule 14a-9 because they omitted material facts, including the fact that Defendants were causing KLA-Tencor to engage in an options backdating scheme, a fact which Defendants were aware of and participated in from at least 1994.

192. In the exercise of reasonable care, Defendants should have known that the Proxy Statements were materially false and misleading.

193. The misrepresentations and omissions in the Proxy Statements were material to plaintiffs in voting on each Proxy Statement. The Proxy Statements were an essential link in the accomplishment of the continuation of Defendants’ unlawful stock option backdating scheme, as revelations of the truth would have immediately thwarted a continuation of shareholders’ endorsement of the directors’ positions, the executive officers’ compensation and the Company’s compensation policies.

194. The Company was damaged as a result of the material misrepresentations and omissions in the Proxy Statements.

COUNT III**Violations of Section 20(a) of the Exchange Act Against
Defendants Levy, Schroeder, Wallace, Kispert, Hall, Tompkins,
Urbanek, Bingham, Bond, Barnholt and Kaufman**

195. Plaintiffs incorporate by reference and reallege each and every allegation set forth above, as though fully set forth herein.

196. Plaintiffs bring this claim against defendants Levy, Schroeder, Wallace, Kispert, Hall, Tompkins, Urbanek, Bingham, Bond, Barnholt and Kaufman.

197. Defendants named in this Count, by virtue of their positions with KLA-Tencor and their specific acts, were, at the time of the wrongs alleged herein, controlling persons of KLA-Tencor within the meaning of §20(a) of the Exchange Act. They had the power and influence and exercised the same to cause KLA-Tencor to engage in the illegal conduct and practices complained of herein.

COUNT IV**Accounting**

198. Plaintiffs incorporate by reference and reallege each and every allegation set forth above, as though fully set forth herein.

199. At all relevant times, Defendants, as directors and/or officers of KLA-Tencor, owed the Company and its shareholders fiduciary duties of good faith, care, candor and loyalty.

200. In breach of their fiduciary duties owed to KLA-Tencor and its shareholders, the Defendants caused KLA-Tencor, among other things, to grant backdated stock options to themselves and/or certain other officers and directors of KLA-Tencor. By this wrongdoing, Defendants breached their fiduciary duties owed to KLA-Tencor and its shareholders.

201. Defendants possess complete and unfettered control over their improperly issued stock option grants and the books and records of the Company concerning the details of such improperly backdated stock option grants to Defendants.

202. As a result of Defendants' misconduct, KLA-Tencor has been substantially injured and damaged financially and is entitled to a recovery as a result thereof, including the proceeds of those improperly granted options which have been exercised and sold.

COUNT V

COUNT VI**Abuse of Control Against All Defendants**

210. Plaintiffs incorporate by reference and reallege each and every allegation set forth above, as though fully set forth herein.

211. Defendants employed the alleged scheme for the purpose of maintaining and entrenching themselves in their positions of power, prestige and profit at, and control over, KLA-Tencor, and to continue to receive the substantial benefits, salaries and emoluments associated with their positions at KLA-Tencor. As a part of this scheme, Defendants actively made and/or participated in the making of or aided and abetted the making of, misrepresentations regarding KLA-Tencor.

212. Defendants' conduct constituted an abuse of their ability to control and influence KLA-Tencor.

213. By reason of the foregoing, KLA-Tencor has been damaged.

COUNT VII**Gross Mismanagement Against All Defendants**

214. Plaintiffs incorporate by reference and reallege each and every allegation set forth above, as though fully set forth herein.

215. Defendants had a duty to KLA-Tencor and its shareholders to prudently supervise, manage and control the operations, business and internal financial accounting and disclosure controls of KLA-Tencor.

216. Defendants, by their actions and by engaging in the wrongdoing described herein, abandoned and abdicated their responsibilities and duties with regard to prudently managing the businesses of KLA-Tencor in a manner consistent with the duties imposed upon them by law. By committing the misconduct alleged herein, Defendants breached their duties of due care, diligence and candor in the management and administration of KLA-Tencor's affairs and in the use and preservation of KLA-Tencor's assets.

217. During the course of the discharge of their duties, Defendants knew or recklessly disregarded the unreasonable risks and losses associated with their misconduct, yet Defendants

1 caused KLA-Tencor to engage in the scheme complained of herein which they knew had an
2 unreasonable risk of damage to KLA-Tencor, thus breaching their duties to the Company. As a
3 result, Defendants grossly mismanaged KLA-Tencor.

4 218. By reason of the foregoing, KLA-Tencor has been damaged.

5 **COUNT VIII**

6 **Constructive Fraud Against All Defendants**

7 219. Plaintiffs incorporate by reference and reallege each and every allegation set forth
8 above, as though fully set forth herein.

9 220. As corporate fiduciaries, Defendants owed to KLA-Tencor and its shareholders a duty
10 of candor and full accurate disclosure regarding the true state of KLA-Tencor's business and assets
11 and their conduct with regard thereto.

12 221. As a result of the conduct complained of, Defendants made, or aided and abetted the
13 making of, numerous misrepresentations to and/or concealed material facts from KLA-Tencor's
14 shareholders despite their duties to, *inter alia*, disclose the true facts regarding their stewardship of
15 KLA-Tencor. Thus they have committed constructive fraud and violated their duty of candor.

16 222. By reason of the foregoing, KLA-Tencor has been damaged.

17 **COUNT IX**

18 **Corporate Waste Against All Defendants**

19 223. Plaintiffs incorporate by reference and reallege each and every allegation set forth
20 above, as though fully set forth herein.

21 224. By failing to properly consider the interests of the Company and its public
22 shareholders, by failing to conduct proper supervision, by giving away millions of dollars to
23 Defendants via the options backdating scheme, Defendants have caused KLA-Tencor to waste
24 valuable corporate assets.

25 225. As a result of Defendants' corporate waste, they are liable to the Company.

COUNT X**Unjust Enrichment Against All Defendants**

226. Plaintiffs incorporate by reference and reallege each and every allegation set forth above, as though fully set forth herein.

227. As a result of the conduct described above, Defendants will be and have been unjustly enriched at the expense of KLA-Tencor, in the form of unjustified salaries, benefits, bonuses, stock option grants and other emoluments of office.

228. Certain Defendants also obtained severance benefits that were not earned or justified but were instead paid as part of a scheme to cover up Defendants' complicity in the scheme.

229. All the payments and benefits provided to Defendants were at the expense of KLA-Tencor. The Company received no benefit from these payments. KLA-Tencor was damaged by such payments.

230. Certain of the Defendants sold KLA-Tencor stock for a profit during the period of deception, misusing confidential non-public corporate information. These Defendants should be required to disgorge the gains which they have and/or will otherwise unjustly obtain at the expense of KLA-Tencor. A constructive trust for the benefit of the Company should be imposed thereon.

COUNT XI**Against the Officer Defendants for Rescission**

231. Plaintiffs incorporate by reference and reallege each and every allegation contained above as though fully set forth herein.

232. As a result of the acts alleged herein, the stock option contracts between the Officer Defendants and KLA-Tencor entered into during the Relevant Period were obtained through Defendants' fraud, deceit, and abuse of control. Further, the backdated stock options were illegal grants and thus invalid as they were not authorized in accordance with the terms of the publicly filed contracts regarding the Officer Defendants' employment agreements and the Company's Stock Option Plan which was also approved by KLA-Tencor shareholders and filed with the SEC.

233. All contracts which provide for stock option grants between the Officer Defendants and KLA-Tencor and were entered into during the Relevant Period should, therefore, be rescinded,

1 with all sums paid under such contracts returned to the Company, and all such executory contracts
2 cancelled and declared void.

3 **COUNT XII**

4 **Against the Insider Selling Defendants for Violation of**
5 **California Corporations Code Section 25402**

6 234. Plaintiffs incorporate by reference and reallege each and every allegation set forth
7 above, as though fully set forth herein.

8 235. At the time that the Insider Selling Defendants sold their KLA-Tencor common stock
9 as set forth herein at ¶27, by reason of their high executive and/or directorial positions with KLA-
10 Tencor, the Insider Selling Defendants had access to highly material information regarding the
11 Company, including the information set forth herein regarding the true adverse facts of KLA-
12 Tencor's improper accounting.

13 236. At the time of such sales, that information was not generally available to the public or
14 the securities markets. Had such information been generally available, it would have significantly
15 reduced the market price of KLA-Tencor shares at that time.

16 237. The Insider Selling Defendants, and each of them, had actual knowledge of material,
17 adverse non-public information and thus sold their KLA-Tencor common stock in California in
18 violation of Cal. Corp. Code §25402.

19 238. Pursuant to California Corporations Code §25502.5, the Insider Selling Defendants,
20 and each of them, are liable to KLA-Tencor for damages in an amount up to three times the
21 difference between the price at which KLA-Tencor common stock was sold by these Defendants,
22 and each of them, and the market value which KLA-Tencor common stock would have had at the
23 time of the sale if the information known to these Defendants, and each of them, had been publicly
24 disseminated prior to that time and a reasonable time had elapsed for the market to absorb the
25 information.

COUNT XIII**Against the Insider Selling Defendants for Breach of Fiduciary Duties for Insider Selling and Misappropriation of Information**

239. Plaintiffs incorporate by reference and reallege each and every allegation set forth above, as though fully set forth herein.

240. At the time of the stock sales set forth herein, the Insider Selling Defendants knew the information described above, and sold KLA-Tencor common stock on the basis of such information.

241. The information described above was proprietary non-public information concerning the Company's financial condition and future business prospects. It was a proprietary asset belonging to the Company, which the Insider Selling Defendants used for their own benefit when they sold KLA-Tencor common stock.

242. At the time of their stock sales, the Insider Selling Defendants knew that the Company's revenues were materially overstated. The Insider Selling Defendants' sales of KLA-Tencor common stock while in possession and control of this material adverse non-public information was a breach of their fiduciary duties of loyalty and good faith.

243. Since the use of the Company's proprietary information for their own gain constitutes a breach of the Insider Selling Defendants' fiduciary duties, the Company is entitled to the imposition of a constructive trust on any profits the Insider Selling Defendants obtained thereby.

PRAYER FOR RELIEF

WHEREFORE, plaintiffs demand judgment as follows:

A. Awarding money damages against all Defendants, jointly and severally, for all losses and damages suffered as a result of the acts and transactions complained of herein, together with pre-judgment interest, to ensure Defendants do not participate therein or benefit thereby;

B. Directing all Defendants to account for all damages caused by them and all profits and special benefits and unjust enrichment they have obtained as a result of their unlawful conduct, including all salaries, bonuses, fees, stock awards, options and common stock sale proceeds and imposing a constructive trust thereon;

1 C. Directing KLA-Tencor to take all necessary actions to reform and improve its
2 corporate governance and internal control procedures to comply with applicable law, including, but
3 not limited to, putting forward for a shareholder vote resolutions for amendments to the Company's
4 By-Laws or Articles of Incorporation and taking such other action as may be necessary to place
5 before shareholders for a vote adoption of the following Corporate Governance Policies:

6 (i) a proposal requiring that the office of CEO of KLA-Tencor and
7 Chairman of the KLA-Tencor Board be permanently held by separate individuals and that the
8 Chairman of the KLA-Tencor Board meets rigorous "independent" standards;

9 (ii) a proposal to strengthen the KLA-Tencor Board's supervision of
10 operations and develop and implement procedures for greater shareholder input into the policies and
11 guidelines of the Board;

12 (iii) appropriately test and then strengthen the internal audit and control
13 functions;

14 (iv) rotate independent auditing firms every five years;

15 (v) control and limit insider stock selling and the terms and timing of
16 stock option grants; and

17 (vi) reform executive compensation.

18 D. Ordering the imposition of a constructive trust over Defendants' stock options and
19 any proceeds derived therefrom;

20 E. Awarding punitive damages;

21 F. Awarding costs and disbursements of this action, including reasonable attorneys',
22 accountants', and experts' fees; and

23 G. Granting such other and further relief as this Court may deem just and proper.
24
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27
28

JURY DEMAND

Plaintiffs demand a trial by jury.

DATED: February 20, 2007

LERACH COUGHLIN STOIA GELLER
RUDMAN & ROBBINS LLP
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MONIQUE C. WINKLER
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Lead Counsel for Plaintiffs

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VERIFICATION

I, SHAWN A. WILLIAMS, hereby declare as follows:

2. I am a member of the law firm of Lerach Coughlin Stoia Geller Rudman & Robbins, LLP, counsel for plaintiff in the above-entitled action. I have read the foregoing Complaint and know the contents thereof. I am informed and believe the matters therein are true and on that ground allege that the matters stated therein are true.

3. I make this Verification because plaintiff is absent from the County of San Francisco where I maintain my office.

Executed this 20th day of February 2007 at San Francisco, California.

/s/Shawn A. Williams
SHAWN A. WILLIAMS

CERTIFICATE OF SERVICE

I hereby certify that on February 20, 2007 I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the e-mail addresses denoted on the attached Electronic Mail Notice List, and I hereby certify that I have mailed the foregoing document or paper via the United States Postal Service to the non-CM/ECF participants indicated on the attached Manual Notice List.

/s/Shawn A. Williams

SHAWN A. WILLIAMS

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Manual Notice List

The following is the list of attorneys who are **not** on the list to receive e-mail notices for this case (who therefore require manual noticing). You may wish to use your mouse to select and copy this list into your word processing program in order to create notices or labels for these recipients.

- (No manual recipients)

EXHIBIT 4
Part 1 of 5

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10
11 **UNITED STATES DISTRICT COURT**
12 **NORTHERN DISTRICT OF CALIFORNIA**

13
14 IN RE KLA-TENCOR CORP. SECURITIES
15 LITIGATION

Master File No. 06-cv-04065-MJJ

16 CLASS ACTION

17 THIS DOCUMENT RELATES TO:
18 ALL ACTIONS

19 **CONSOLIDATED FEDERAL
SECURITIES CLASS ACTION
COMPLAINT**

JURY TRIAL DEMANDED

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1 Lead Plaintiffs Police and Fire Retirement System of the City of Detroit ("PFRS"),
2 Louisiana Municipal Police Employees' Retirement System ("MPERS") and the City of
3 Philadelphia Board of Pensions and Retirement ("CPBPR"), by their attorneys, on behalf of
4 themselves and all others similarly situated, allege the following based upon the investigation of
5 Lead Plaintiffs' counsel, except as to the allegations specifically pertaining to Lead Plaintiffs,
6 which are based upon personal knowledge. The investigation of counsel included, among other
7 things, a review of KLA-Tencor Corporation's ("KLA" or the "Company") public filings with
8 the United States Securities and Exchange Commission ("SEC"), press releases issued by the
9 Company, media and news reports about the Company, publicly available trading data for
10 KLA's securities and interviews with former employees of the Company ("Confidential
11 Witnesses").

12 **I. NATURE OF THE ACTION**

13 1. This is a class action brought on behalf of a class consisting of all persons who
14 purchased publicly traded securities of KLA between June 30, 2001 and May 21, 2006,
15 inclusive ("Class Period"). The following are named as defendants in this action: KLA,
16 Richard P. Wallace, Kenneth L. Schroeder, Kenneth Levy, Jon D. Tompkins, Stephen P.
17 Kaufman, Gary E. Dickerson, Jeffrey L. Hall, John H. Kispert, Lida Urbanek, Michael E.
18 Marks, Edward W. Barnholt, Robert T. Bond, Richard J. Elkus, Jr., H. Raymond Bingham,
19 Dean O. Morton, Stuart J. Nichols and Robert J. Boehlke.

20 2. This action involves an *admitted intentionally* fraudulent scheme that spanned
21 nearly a decade. At the crux of the fraudulent scheme was a practice whereby defendants
22 intentionally manipulated stock option grants to the Company's officers, directors and
23 employees in order to provide the recipients with a more profitable exercise price. The
24 Company has *admitted* that some of its executives had engaged in this scheme knowingly. As a
25 result of this scheme, *the Company has been forced to restate its previously filed financial*
26 *statements* for fiscal years ended June 30, 2005 and 2004 and selected consolidated financial
27 data for fiscal years ended June 30, 2005, 2004, 2003 and 2002 *by over \$375 million*. This
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1 restatement represents *one of the largest restatements (or projected restatement) of any*
2 *company that has admitted to options backdating.* According to the scorecard kept by *The*
3 *Wall Street Journal*, approximately 62 companies have announced restatements and KLA is in
4 the top five in terms of dollar value of the projected or announced restatements.

5 3. Publicly traded companies routinely award stock options to their officers,
6 directors and employees. Stock options are granted as part of compensation packages to create
7 incentives to boost profitability and stock value. Such stock options allow the officer, director
8 or employee to purchase company stock at a specified price ("exercise price" or "strike price")
9 for a specific period of time. When an officer, director or employee exercises the option, he or
10 she purchases the stock from the company at the exercise price, regardless of the stock's price at
11 the time the option is exercised. The lower the exercise price, the more profit the officer,
12 director or employee can potentially make and the less money the company gets when the stock
13 option is exercised. When the exercise price of an option grant is set at the market price on the
14 date of the grant, *i.e.*, "at-the-money," the option holder will profit only if the stock price goes
15 up over time. Thus, one of the benefits of such stock options is that they align the interests of
16 the officers, directors and employees with the interests of the company's shareholders because
17 the value of the options only increases if the company's stock price increases. When, however,
18 the option is set below the market price on the date of the grant, *i.e.*, "in-the-money," the option
19 holder receives options that immediately have value.

20 4. In early 2006, it came to light that a number of publicly traded companies had
21 been manipulating the exercise price of option grants to officers, directors and employees in
22 improper ways and for improper purposes. The main type of price manipulation is referred to
23 as "backdating." Backdating is the process of retroactively cherry picking an earlier date –
24 when the underlying stock price was lower – as the grant date in order to assign a lower
25 exercise price to the option.

26 5. Here, defendants manipulated the stock option grants to officers, directors and
27 employees from the late 1990s through the entire Class Period in a number of ways. Most
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1 notably, *the Company has admitted that “certain of our stock options primarily those granted*
2 *from July 1, 1997 to June 30, 2002, had been retroactively priced for all employees who*
3 *received these grants.... This means that the option exercise price was not the market price*
4 *of the option shares on the actual grant date of the option, but instead was a lower market*
5 *price on an earlier date. The actual grant date – when the essential actions necessary to*
6 *grant the option were completed, including the final determination of the number of shares to*
7 *be granted to each employee and the exercise price – is the correct measurement date to*
8 *determine the market price of the option shares under the accounting rules in effect at the*
9 *time.”* (Emphasis added.)

10 6. Stock option manipulation and, in particular, the practice of granting an option
11 with an exercise price tied to a date prior to the actual grant date is fraudulent where, for
12 example, (a) the backdating of grant dates violates the terms of the company’s stock option
13 plan; (b) the company misrepresents how the options are priced; or (c) the company fails to
14 properly record expenses associated with these option grants under Generally Accepted
15 Accounting Principles (“GAAP”). All three of these circumstances existed here.

16 7. Defendants’ manipulation of – and, in particular, the backdating of – stock
17 option grants was not a legitimate exercise of their discretion to grant options. Rather, it was
18 the linchpin of a broader fraudulent scheme to profit from increases in the Company’s stock
19 price with the benefit of hindsight and to misrepresent and withhold truthful material
20 information from the public about this scheme. In furtherance of this fraudulent scheme,
21 defendants engaged in the following misconduct:

22 (a) Defendants failed to report expenses associated with the backdated
23 options and thereby materially understated KLA’s expenses and materially overstated its net
24 income and earnings per share in direct contravention of the most basic GAAP principles. If the
25 options are priced below a stock’s fair market value when they are awarded, there is an instant
26 paper gain. Pursuant to Accounting Principles Board (“APB”) Opinion No. 25 “Accounting for
27 Stock Issued to Employees” (“APB No. 25”), which was in effect through June 2005, the
28

1 Company was obligated to recognize this gain as compensation expense over the vesting period
2 of the option. After June 2005, Statement of Financial Accounting Standards (“SFAS”) 123,
3 “Accounting For Stock-Based Compensation” (“SFAS 123”), required that the Company
4 recognize the entire value of the options on the grant date over the vesting period of the option.
5 However, as the Company just recently admitted, *“the retroactively priced options were not*
6 *accounted for correctly in our previously issued financial statements” under either of these*
7 *two GAAP principles. Accordingly, the Company was forced to restate its prior financial*
8 *results by recording additional pre-tax, non-cash, stock-based compensation expense of (i)*
9 *\$348 million for the periods July 1, 1994 to June 30, 2005 under APB Opinion No. 25”; and*
10 *(ii) “\$28 million for the period from July 1, 2005 through December 31, 2006 under SFAS*
11 *No. 123(R)” in order “[to] correct our past accounting for stock options.” (“Restatement”)*
12 (Emphasis added.). A further restatement for the third quarter of fiscal year 2006 (“Q3FY06”) is still pending.

14 (b) By retroactively pricing the options, defendants also caused the Company
15 to issue options with terms that violated the express requirements of the Company’s stock
16 option plans, which rendered the Company’s public representations that options were issued in
17 compliance with the Company’s stock option plans false and misleading. Specifically, three of
18 the Company’s stock option plans – the Restated 1982 Stock Option Plan, the 1998 Outside
19 Director Option Plan and the 2004 Equity Incentive Plan – expressly state that the exercise
20 price of the options shall not be less than 100% of the fair market value of the stock on the date
21 of the grant. However, where, as here, options are backdated, the exercise price of the stock
22 options is lower than the fair market value on the true date of the grant.

23 (c) Defendants also repeatedly misled investors by affirmatively representing
24 in Company filings that, since it was the Company’s philosophy to “motivate executive officers
25 to achieve the Company’s business objectives and to align the interests of executive officers
26 with the long term interests of stockholders,” “the exercise price of the options shall not be less
27 than 100% of the fair market value of the stock on the date of the grant.”

1 (d) Defendants also expressly misrepresented the value of officer and
2 director compensation in various Company filings, particularly the proxy statements
3 disseminated to investors in connection with the annual shareholder meetings. Specifically, in
4 identifying specific options granted to the officers and directors, defendants falsely stated that
5 such options were granted with an exercise price equal to the fair market value of the stock on
6 the grant date when, in fact, the options granted were backdated and thus "in-the-money" when
7 granted.

8 8. By issuing its Restatement, KLA *conceded that its prior financial statements*
9 *about its financial results were materially false and misleading when made* because such
10 statements omitted material facts regarding the fact and financial effect of the backdated option
11 grants. Moreover, *the Company has expressly admitted* in its annual report on Form 10-K for
12 the period ended June 30, 2006 ("2006 Form 10-K") *that the fraud has had a material impact*
13 *on the Company and its shareholders* in a number of ways:

- 14 • "The discovery that *we had retroactively priced stock options* (primarily from July 1,
15 1997 to June 30, 2002) *and had not accounted for them correctly* has had, and may
continue to have, a material adverse effect on our financial results." (Emphasis added.)
- 16 • "The ongoing government inquiries relating to our historical stock option practices are
17 time consuming and expensive and *could result in injunctions, fines and penalties that*
18 *may have a material adverse effect on our financial condition and results of*
operations." (Emphasis added.)
- 19 • "The Special Committee investigation and restatement activities have required us to
20 expend significant management time and incur significant accounting, legal, and other
expenses. *The resulting restatements have had a material adverse effect on our*
results of operations." (Emphasis added.)

21 9. There is no doubt that the backdating of the option grants and corresponding
22 public misrepresentations were the result of intentional and opportunistic acts. Indeed, the
23 Company has made the following additional key admissions in its 2006 Form 10-K:

- 24 • "*There was retroactive pricing of stock options granted to all employees* who received
25 options, primarily during the periods from July 1, 1997 to June 30, 2002." (Emphasis
added.)
- 26 • "*[T]he retroactive pricing of options involved the falsification of Company records,*
27 *resulting in erroneous statements* being made in financial and other reports previously
28 filed with the SEC, as a well as in information previously provided to our independent
registered public accounting firm." (Emphasis added.)

- 1 • “[T]he retroactive pricing of options was intentional, not inadvertent or through
2 administrative error.” (Emphasis added.)
- 3 • “[T]he retroactive pricing of options involved the selection of fortuitously low exercise
4 prices by certain former executive officers, and other former executives may have
5 been aware of this conduct.” (Emphasis added.)
- 6 • “The individual who served as the Company’s Chief Executive Officer during part of
7 that time period and continuing until midway through the last fiscal year, was
8 involved in the past retroactive pricing of stock options.” (Emphasis added.) Based on
9 public filings, the individual who held these positions was *Schroeder*.
- 10 • Under the “Findings and Remedial Actions” section of the 2006 Form 10-K, the
11 Company stated that, “[a]s result of the Special Committee investigation, on October 16,
12 2006, we terminated our employment relationship and agreement with *Kenneth L.*
13 *Schroeder*, and we announced our intent to cancel all outstanding stock options held
14 by Mr. *Schroeder* that were retroactively priced or otherwise improperly granted.
15 Those options were canceled in December 2006.... Accordingly, in the second quarter
16 of fiscal 2007 the Company will reverse approximately \$20 million of the non-cash,
17 stock-based compensation recorded in prior periods....” (Emphasis added.)
- 18 • Under the “Findings and Remedial Actions” section of the 2006 Form 10-K, the
19 Company also stated that *Nichols and Levy had resigned* in fall 2006 and that the
20 Company had entered into agreements with both Nichols and Levy whereby the
21 Company *re-priced their outstanding retroactively priced stock options by increasing*
22 *the exercise price to the market price of the option shares on the actual grant date.*
23 While the Company attempted to shield others whose backdated options were re-priced
24 by including a caveat regarding their alleged lack of involvement in the scheme, it
25 provided no such caveat for Nichols and Levy, thereby acknowledging their
26 involvement.

17 10. There is no doubt that this extensive fraud injured Lead Plaintiffs and members
18 of the Class. From the very first published announcement of potential backdating at KLA on
19 May 22, 2006, the market has reacted to the news and the stock price has fallen as the prior
20 artificial inflation was removed from the value of KLA’s securities. Specifically, after *The Wall*
21 *Street Journal* issued the first article raising the strong possibility of backdating at KLA and the
22 Company revealed that the Department of Justice (“DOJ”) was investigating possible
23 backdating, the price of KLA common stock plummeted from a closing price of \$45.24 per
24 share on May 19, 2006 to a closing price of \$40.54 on May 22, 2006, *on heavy volume of*
25 *13,615,220 shares traded - which was three times the average trading volume for the prior*
26 *three months.* This one-day drop alone amounted to a *market capitalization loss of*
27 *approximately \$935 million.*

1 11. Moreover, by issuing false and misleading statements regarding officer and
2 director compensation as well as the terms of a new option plan in the proxy statements,
3 defendants deprived Lead Plaintiffs and other Class members of their basic corporate suffrage
4 rights in connection with their voting rights at the annual shareholder meetings.

5 **II. JURISDICTION AND VENUE**

6 12. This Court has jurisdiction over the subject matter of this action pursuant to
7 Section 27 of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. §78aa, and 28
8 U.S.C. §1331. The claims asserted herein arise under Sections 10(b), 14(a), 20(a) and 20A of
9 the Exchange Act, 15 U.S.C. §§78j(b), 78n(a), 78t(a) and 78t-1, and Rules 10b-5 and 14a-9
10 promulgated thereunder by the SEC, 17 C.F.R. §§240.10b-5 and 240.14a-9.

11 13. Venue is proper in this District pursuant to Section 27 of the Exchange Act and
12 28 U.S.C. §1391(b) and (c). KLA's principal executive offices are located in this District,
13 defendants transacted business in this District and many of the acts and transactions constituting
14 the violations of law alleged herein, including the preparation, issuance and dissemination of
15 materially false and misleading statements to the investing public, occurred in this District.

16 14. In connection with the acts, conduct and other wrongs alleged herein,
17 defendants, directly and indirectly, used the means and instrumentalities of interstate commerce,
18 including the United States mails, interstate telephone communications and national securities
19 markets.

20 **III. THE PARTIES**

21 **A. THE LEAD PLAINTIFFS**

22 15. Plaintiff PFRS purchased KLA securities during the Class Period, as set forth in
23 the certification previously filed with the Court, and suffered damages as a result of the
24 wrongful acts of defendants alleged herein. Moreover, PFRS had standing to vote in connection
25 with each of the proxy statements alleged herein, as it held shares on the requisite dates.

26 16. Plaintiff MPERS purchased KLA securities during the Class Period, as set forth
27 in the certification previously filed with the Court, and suffered damages as a result of the
28

1 wrongful acts of defendants alleged herein. Moreover, MPERS had standing to vote in
2 connection with each of the proxy statements alleged herein, as it held shares on the requisite
3 dates.

4 17. Plaintiff CPBPR purchased KLA securities during the Class Period, as set forth
5 in the certification previously filed with the Court, and suffered damages as a result of the
6 wrongful acts of defendants alleged herein. Moreover, CPBPR had standing to vote in
7 connection with each of the proxy statements alleged herein, as it held shares on the requisite
8 dates.

9 18. By Order dated October 13, 2006, PFRS, MPERS and CPBPR were appointed
10 Lead Plaintiffs in this action.

11 **B. THE DEFENDANTS**

12 **(i) The Company**

13 19. KLA maintains its principal executive offices at 160 Rio Robles, San Jose,
14 California 95134. The Company purports to be the world's leading supplier of process control
15 and yield management solutions for the semiconductor and related microelectronics industries.
16 KLA's portfolio of products, software, analysis and services is designed to help integrated
17 circuit ("IC") manufacturers manage yield throughout the entire fabrication process – from
18 research and development to final mass-production yield analysis. According to the Company,
19 virtually every major wafer, IC and photomask manufacturer in the world uses KLA's products
20 and services. These customers use KLA's products and services for (a) inline wafer defect
21 monitoring; (b) reticle and photomask defect inspection; (c) critical dimension metrology; (d)
22 wafer overlay; (e) film and surface measurement; and (f) overall yield and fab-wide data
23 analysis. The Company acts by and through its officers and directors, including defendants.

24 **(ii) The Officer Defendants: Wallace, Schroeder,**
25 **Dickerson, Kispert, Hall, Boehlke and Nichols**

26 20. Richard P. Wallace ("Wallace") is the current Chief Executive Officer ("CEO")
27 and is a director of the Company. He was appointed CEO of the Company on January 1, 2006
28

1 and has served as a director since January 2006. Wallace was President and Chief Operating
2 Officer ("COO") from July 2005 through December 2005. He was Executive Vice President of
3 the Customer Group from May 2004 to July 2005 and Executive Vice President of the Wafer
4 Inspection, Review & Analysis Group from July 2000 to May 2004. Wallace signed false and
5 misleading KLA filings during the Class Period, including the Company's quarterly reports on
6 Form 10-Q for the period ended December 31, 2005 ("Q2FY06") and for Q3FY06. Wallace
7 also certified the Form 10-Qs filed for Q2FY06 and Q3FY06. Wallace is a citizen of the State
8 of California.

9 21. Kenneth L. Schroeder ("Schroeder") served as a director and CEO of the
10 Company from July 1999 until January 1, 2006. Schroeder also served as President of the
11 Company from November 1991 to July 2002 and again from May 2004 to July 2005. He was
12 COO of the Company from November 1991 until June 1999. Schroeder served on the
13 Nominating and Governance Committee of the Board of Directors during fiscal years 2001 and
14 2002. According to the Company's 2006 Form 10-K, Schroeder was a member of the
15 Company's Stock Option Committee from 1994 until December 31, 2005 and was employed as
16 a Senior Advisor to the Company from January 1, 2006 through October 16, 2006. Schroeder
17 signed false and misleading KLA filings during the Class Period, including the Company's
18 quarterly reports on Form 10-Q for the periods ended September 30, 2002 ("Q1FY03"),
19 December 31, 2002 ("Q2FY03"), March 31, 2003 ("Q3FY03"), September 30, 2003
20 ("Q1FY04"), December 31, 2003 ("Q2FY04"), March 31, 2004 ("Q3FY04"), September 30,
21 2004 ("Q1FY05"), December 31, 2004 ("Q2FY05"), March 31, 2005 ("Q3FY05") and
22 September 30, 2005 ("Q1FY06") and the Form 10-Ks filed for fiscal years ended June 30, 2001
23 ("2001 Form 10-K"), June 30, 2002 ("2002 Form 10-K"), June 30, 2003 ("2003 Form 10-K"),
24 June 30, 2004 ("2004 Form 10-K") and June 30, 2005 ("2005 Form 10-K"). Schroeder also
25 certified the Form 10-Qs filed for Q1FY03, Q2FY03, Q3FY03, Q1FY04, Q2FY04, Q3FY04,
26 Q1FY05, Q2FY05, Q3FY05 and Q1FY06 and the 2001, 2002, 2003, 2004 and 2005 Form 10-
27 Ks. Schroeder is a citizen of the State of California.

28

1 22. Gary E. Dickerson ("Dickerson") served as President of the Company from July
2 2002 to April 2004 and as COO of the Company from July 1999 to April 2004. He served as
3 Executive Vice President of the Customer Group from July 1997 to June 30, 1999. He was also
4 named Senior Vice President, New Business Operations in May 2004. According to a
5 Confidential Witness, Dickerson was also a member of KLA's Stock Option Committee.
6 Dickerson is a citizen of the State of California.

7 23. Jeffrey L. Hall ("Hall") is the current Chief Financial Officer ("CFO") of the
8 Company. He was appointed Senior Vice President and CFO in January 2006. From July 2004
9 until his appointment as CFO on January 1, 2006, Hall was Vice President of Finance, Tax and
10 Treasury. From July 2003 through July 2004, Hall served as Vice President, Finance and
11 Accounting and, from April 2001 to July 2003, he was Vice President, Mergers and
12 Acquisitions and Corporate Planning. As CFO and VP of Finance during the Class Period,
13 defendant Hall was responsible for the preparation of the Company's financial statements and
14 for ensuring that the periodic reports filed with the SEC containing such financial statements
15 complied fully with the disclosure requirements of the federal securities laws. According to a
16 Confidential Witness, Hall was also a member of KLA's Stock Option Committee. Hall signed
17 false and misleading KLA filings during the Class Period, including the Company's quarterly
18 reports on Form 10-Q for the periods ended Q2FY06 and Q3FY06. Hall also certified the Form
19 10-Qs filed for Q2FY06 and Q3FY06. Hall earned his bachelor's degree in finance from
20 Indiana University and his master's degree in business administration from the University of
21 Dayton. Hall is a citizen of the State of California.

22 24. John H. Kispert ("Kispert") is the current President and COO of the Company.
23 He was appointed President and COO on January 1, 2006. From July 2000 until his
24 appointment as President and COO, he served as Executive Vice President and CFO of the
25 Company. As CFO during the Class Period, Kispert was responsible for the preparation of the
26 Company's financial statements and for ensuring that the periodic reports filed with the SEC
27 containing such financial statements complied fully with the disclosure requirements of the
28

1 federal securities laws. According to a Confidential Witness, Kispert was a member of the
2 KLA's Stock Option Committee. Kispert signed false and misleading KLA filings during the
3 Class Period, including the Company's quarterly reports on Form 10-Q for the periods ended
4 March 31, 2001 ("Q3FY01"), September 30, 2001 ("Q1FY02"), December 31, 2001
5 ("Q2FY02"), March 31, 2002 ("Q3FY02"), Q1FY03, Q2FY03, Q3FY03, Q1FY04, Q2FY04,
6 Q3FY04, Q1FY05, Q2FY05, Q3FY05 and Q1FY06 and the 2001, 2002, 2003, 2004 and 2005
7 Form 10-Ks. Kispert also certified the Form 10-Qs filed for Q1FY03, Q2FY03, Q3FY03,
8 Q1FY04, Q2FY04, Q3FY04, Q1FY05, Q2FY05, Q3FY05 and Q1FY06 and the 2001, 2002,
9 2003, 2004 and 2005 Form 10-Ks. Kispert obtained his master's degree in business
10 administration from the University of California, Los Angeles. Kispert is a citizen of the State
11 of California.

12 25. Robert J. Boehlke ("Boehlke") served as Executive Vice President and CFO of
13 the Company from 1990 until his retirement in 2000. Between 1983 and 1990, he held various
14 management positions at KLA. As CFO, Boehlke was responsible for the preparation of the
15 Company's financial statements and for ensuring that the periodic reports filed with the SEC
16 containing such financial statements complied fully with the disclosure requirements of the
17 federal securities laws. Boehlke received his master's degree in business administration from
18 Harvard University. Boehlke is a citizen of the State of California.

19 26. Stuart J. Nichols ("Nichols") was Vice President and General Counsel of KLA
20 from 2000 until his resignation on October 16, 2006. According to a Confidential Witness,
21 Nichols was a member of KLA's Stock Option Committee. Nichols signed false and
22 misleading KLA filings during the Class Period, specifically the Notice of Annual Meeting of
23 Stockholders for the 2002, 2003, 2004 and 2005 Schedule 14A Proxy Statements. Nichols is a
24 citizen of the state of California.

25 27. Wallace, Schroeder, Dickerson, Kispert, Hall Boehlke and Nichols are
26 collectively referred to hereinafter as the "Officer Defendants." By virtue of their high-level
27 positions with the Company, each of the Officer Defendants directly participated in the
28

1 management of the Company, was directly involved in the day-to-day operations of the
2 Company at the highest levels and was privy to confidential proprietary information concerning
3 the Company and its business, operations, growth, financial statements and financial condition.

4 28. As officers of the Company, defendants Wallace, Schroeder, Dickerson, Hall,
5 Kispert and Nichols had extensive duties to ensure the accuracy of information disseminated to
6 investors:

7 (a) As noted in American Institute of Certified Public Accountants
8 ("AICPA") auditing standard, Section 110.03, a public company's management is responsible
9 for preparing financial statements in accordance with GAAP:

10 The financial statements are management's responsibility.... Management is
11 responsible for adopting sound accounting policies and for establishing and
12 maintaining internal controls that will, among other things, initiate, record,
13 process, and report transactions (as well as events and conditions) consistent with
14 management's assertions embodied in the financial statements. The entity's
15 transactions and the related assets, liabilities, and equity are within the direct
16 knowledge and control of management. The auditor's knowledge of these matters
17 and internal controls is limited to that acquired through the audit. Thus, the fair
18 presentation of financial statements in conformity with generally accepted
19 accounting principles is an implicit and integral part of management's
20 responsibility.

21 (b) In Accounting Series Release 173 (July 2, 1975), the SEC reiterated the
22 duty of management to present a true representation of a company's operations:

23 [I]t is important that the overall impression created by the financial statements be
24 consistent with the business realities of the company's financial position and
25 operations.

26 (c) Pursuant to the Sarbanes-Oxley Act of 2002 ("SOX") and SEC rules
27 promulgated thereunder, the CEO and CFO of reporting corporations are required to certify as
28 to the accuracy and completeness of the company's financial statements. In addition,
companies are required to make extensive disclosures in their Proxy Statements and annual
reports regarding officer and director compensation, including stock holdings and exercised and
unexercised stock options.

29. As the Company's own filings also state, "KLA-Tencor's management is
responsible for establishing and maintaining a system for internal controls and the financial

1 reporting process.”

2 (iii) **The Compensation Committee Defendants: Urbanek, Marks,**
3 **Barnholt and Bond**

4 30. Lida Urbanek (“Urbanek”) has served as a director of KLA and as a member of
5 the Compensation Committee of the Board of Directors (“Compensation Committee”) since
6 April 1997. Urbanek signed false and misleading KLA filings during the Class Period,
7 including the 2001, 2002, 2003, 2004 and 2005 Form 10-Ks. Urbanek is a citizen of the State
8 of California.

9 31. Michael E. Marks (“Marks”) was a director of KLA and a member of the
10 Compensation Committee from November 2003 until May 2006. Marks signed false and
11 misleading KLA filings during the Class Period, including the 2004 and 2005 Form 10-Ks.
12 Marks is a citizen of the State of California.

13 32. Edward W. Barnholt (“Barnholt”) has served as a director of KLA since 1995
14 and was named Chairman of the Board of Directors of KLA in October 2006. He has served as
15 a member of the Compensation Committee since 2000 and of the Nominating and Governance
16 Committee since fiscal 2000. Barnholt signed false and misleading KLA filings during the
17 Class Period, including the 2001, 2002, 2003, 2004 and 2005 Form 10-Ks. Barnholt is a citizen
18 of the State of California.

19 33. Robert T. Bond (“Bond”) has served as a director of KLA since August 2000.
20 He has served as a member of the Compensation Committee since 2000 and as Chair of this
21 Committee since 2004. He also has served as a member of the Audit Committee since 2002.
22 Bond signed false and misleading KLA filings during the Class Period, including the 2001,
23 2002, 2003, 2004 and 2005 Form 10-Ks. Bond is a citizen of the State of California.

24 34. Defendants Urbanek, Marks, Barnholt and Bond are collectively referred
25 hereinafter as the “Compensation Committee Defendants.” As members of the Compensation
26 Committee, the Compensation Committee Defendants were responsible for the Company’s
27 public representations regarding options. KLA’s proxy statements generally provide that “the
28

1 Compensation Committee reviews and approves, subject to ratification by the Board of
2 Directors, the Company's executive compensation policy and administers the Company's
3 employee equity award plans." According to KLA's Compensation Committee Charter, the
4 Compensation Committee Defendants participated in decisions regarding the options grants
5 including the setting of option grant dates and exercise prices. More specifically, the
6 Company's Charter for the Compensation Committee states that the purpose of the
7 Compensation Committee is to, *inter alia*, "review and make recommendations to the Board of
8 Directors regarding all forms of compensation to be provided to the executive officers and
9 directors...including...stock compensation to all employees" of the Company. The charter
10 further describes the Compensation Committee's responsibilities as follows:

11 (a) "Two weeks prior to the Compensation Committee meeting, each
12 member of the committee will receive information regarding compensation, option grants,
13 bonuses...."

14 (b) The "Compensation Committee will make a recommendation to the
15 Board on the range of option grants for each level of employee; the compensation, option grants
16 and bonus goals for each officer of at least Vice President...."

17 (c) The Compensation Committee "review[s] and mak[es] recommendations
18 to the Board of Directors regarding the compensation policy for executive officers of and
19 directors of the Company, and such other officers of the Company as directed by the Board."

20 (d) The Compensation Committee "review[s] and mak[es] recommendations
21 to the Board of Directors regarding all forms of compensation (including all 'plan'
22 compensation, as such term is defined in Item 402(a)(7) of Regulation S-K promulgated by the
23 Securities and Exchange Commission, and all non-plan compensation) to be provided to the
24 executive officers of the Company."

25 (e) Members act as administrators for the Company's Option Plans by,
26 among other things, granting stock options or stock purchase rights to eligible individuals.

27 (f) Members prepare a report for inclusion in the Company's proxy
28

1 statements, "which describes (a) the criteria on which compensation paid to the Chief Executive
2 Officer for the last completed fiscal year is based; (b) the relationship of such compensation to
3 the Company's performance; and (c) the Compensation Committee's executive compensation
4 policies applicable to executive officers."

5 (g) Members review and make recommendations to the Board regarding
6 compensation of the independent board members, including option grants.

7 (h) Members prepare written reports to the Board regarding
8 recommendations of the Compensation Committee submitted to the Board for action and
9 provide the Board with copies of written minutes of its meetings.

10 35. During fiscal years 2001, 2002, 2003, 2004, 2005 and 2006, the Compensation
11 Committee met four, two, two, three, four and six times, respectively. The Compensation
12 Committee was required to provide to the Board of Directors its schedule of meetings.

13 36. The Company has expressly represented that, during the Class Period, "all stock
14 option grants to officers are made with a review by, and with the approval of the Compensation
15 Committee of the Board of Directors." See 2002 Form 10-K, Q1FY03 Form 10-Q, 2QFY03
16 Form 10-Q, 3QFY03 Form 10-Q. See also 2003 Form 10-K and 2004 Form 10-K stating that
17 "[a]ll stock option grants to officers are approved by the Compensation Committee of the Board
18 of Directors."

19 37. During the Class Period, the Compensation Committee also prepared reports on
20 executive compensation, which were included in the proxy statements disseminated to
21 shareholders in connection with the annual shareholder meetings.

22 (iv) **The Audit Committee Defendants: Bingham, Elkus, Morton**
23 **Kaufman And Bond**

24 38. H. Raymond Bingham ("Bingham") has served as a director of KLA since
25 October 1999. He has served as a member of the Audit Committee since 2000 and as Chairman
26 of the Audit Committee since 2003. According to KLA's 2004 and 2005 Proxy Statements, the
27 Board determined that Bingham was an "audit committee financial expert" within the meaning
28

1 of the rules promulgated by the [SEC].” Bingham has also been a member of the Nominating
2 and Governance Committee since fiscal year 2006. Bingham signed false and misleading KLA
3 filings during the Class Period, including the 2001, 2002, 2003, 2004 and 2005 Form 10-Ks.
4 Bingham is a citizen of the State of California.

5 39. Richard J. Elkus, Jr. (“Elkus”) has served as a director of KLA from April 1997
6 until November 4, 2005 (fiscal 2006) and was a member of the Audit Committee from 1999
7 until November 4, 2005. He also served on the Nominating and Governance Committee from
8 fiscal 2003 to November 4, 2005. Elkus signed false and misleading KLA filings during the
9 Class Period including the 2001, 2002, 2003, 2004 and 2005 Form 10-Ks. Elkus is a citizen of
10 the State of California.

11 40. Dean O. Morton (“Morton”) served as a director of KLA from April 1997 until
12 July 31, 2002. Morton was a member of the Audit Committee and the Nominating and
13 Governance Committee during fiscal year 2001. Morton received an M.B.A. from Harvard
14 Business School. Morton signed false and misleading KLA filings during the Class Period -
15 specifically, the 2001 Form 10-K. Morton is a citizen of the State of California.

16 41. Stephen P. Kaufman (“Kaufman”) has served as a director of KLA since
17 November 2002. He has been a member of the Audit Committee since November 2002 (fiscal
18 2003). Kaufman has also served as a member of the Nominating and Governance Committee
19 since fiscal year 2005. Kaufman signed false and misleading KLA filings during the Class
20 Period, including the 2003, 2004 and 2005 Form 10-Ks. Kaufman is a citizen of the State of
21 California.

22 42. Bond has also served as a member of the Audit Committee since fiscal year
23 2002.

24 43. Defendants Bingham, Elkus, Morton, Kaufman and Bond are collectively
25 referred to hereinafter as the “Audit Committee Defendants.” KLA’s own reports state that the
26 “Audit Committee is responsible for overseeing KLA-Tencor’s auditing, accounting and
27 financial reporting processes, its system of internal controls, and legal and ethical compliance.”
28

1 According to KLA's Audit Committee Charter, the purpose of the Audit Committee is to, *inter*
2 *alia*:

3 (a) "[O]versee the accounting and financial reporting processes of the
4 Company and the audits of the financial statements of the Company."

5 (b) "Assist the Board of Directors in oversight and monitoring of (i) the
6 integrity of the Company's financial statements; (ii) Company's compliance with legal and
7 regulatory requirements; (iii) the independent auditor's qualifications, independence and
8 performance; and (iv) the Company's internal accounting and financial controls."

9 (c) "Prepare the report that the rules of the [SEC] required to be included in
10 the Company's annual proxy statement."

11 (d) "[P]rovide the Board with the results of its monitoring and
12 recommendations derived therefrom."

13 (e) "[P]rovide to the Board such additional information and materials as it
14 may deem necessary to make the Board aware of significant financial matters that require the
15 attention of the Board."

16 44. The Audit Committee Charter further states that the responsibilities of the Audit
17 Committee include:

18 (a) "Reviewing on a continuing basis the adequacy of the Company's system
19 of internal controls, including meeting periodically with the Company's management and the
20 independent auditors to review the adequacy of such controls and to review before release the
21 disclosure regarding such system of internal controls required under SEC rules to be contained
22 in the Company's periodic filings and the attestations or reports by the independent auditors
23 relating to such disclosure."

24 (b) "Reviewing and discussing with management and independent auditors
25 the annual audited financial statements and quarterly unaudited Financial Statements, including
26 the Company's disclosures under 'Management's Discussion and Analysis of Financial
27 Condition and Results of Operations' to be included in the Company's Annual Report on Form
28

1 10K... and Quarterly Reports on Form 10-Q, respectively, prior to their filing with the SEC.”

2 (c) “Conducting a post-audit review of the financial statements and audit
3 findings.”

4 (d) “Reviewing before release the unaudited quarterly operating results in the
5 Company’s quarterly earnings release.”

6 (e) “Overseeing compliance with the requirements of the SEC for disclosure
7 of auditor’s services and audit committee members, member qualifications and activities.”

8 (f) “Reviewing, approving and monitoring the Company’s code of ethics for
9 its senior financial officers.”

10 (g) “Reviewing, in conjunction with counsel, any legal matters that could
11 have a significant impact on the Company’s financial statements.”

12 (h) “Providing a report in the Company’s proxy statement in accordance
13 with the rules and regulations of the SEC.”

14 45. The Audit Committee Charter further provides that “[e]ach member [of the Audit
15 Committee] will be able to read and understand fundamental financial statements in accordance
16 with the Nasdaq National Market Audit Committee Requirements.” During fiscal years 2001,
17 2002, 2003, 2004, 2005 and 2006, the Audit Committee met five, four, twelve, ten, eleven and
18 six times, respectively.

19 46. In substantially identical language, each of KLA’s Proxy Statements for 2001
20 through 2006 included an Audit Committee report, which stated that, “[b]ased on the reviews
21 and discussions referred to above, the Audit Committee recommended to the Board of
22 Directors, and the Board of Directors approved, the inclusion of the audited financial statements
23 in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, [2001-2006]
24 filed with the [SEC].”

25 (v) **The Nominating and Governance Committee Defendants: Levy,**
26 **Morton, Barnholt, Schroeder, Elkus, Bingham and Kaufman**

27 47. Kenneth Levy (“Levy”), a founder of KLA, served as a director of the Company
28

1 from 1975 through October 16, 2006 and as Chairman of the Board from July 1999 through
2 October 2006, when he retired amidst the Special Committee investigation. Levy also served as
3 CEO of the Company from July 1998 to June 1999 and as a member of the Nominating
4 Committee in at least 2000 and 2001. Levy signed false and misleading KLA filings during the
5 Class Period, including the 2001, 2002, 2003, 2004 and 2005 Form 10-Ks. Levy is a citizen of
6 the State of California.

7 48. Morton was a member of the Nominating and Governance Committee during
8 fiscal year 2001.

9 49. Barnholt has been a member of the Nominating and Governance Committee
10 since fiscal year 2000 and served as chairman of the Nominating and Governance Committee
11 during fiscal years 2004, 2005 and 2006.

12 50. Schroeder was a member of the Nominating and Governance Committee during
13 at least fiscal years 2001 and 2002.

14 51. Elkus was a member of the Nominating and Governance Committee from fiscal
15 year 2003 to November 4, 2005.

16 52. Bingham has been a member of the Nominating and Governance Committee
17 since fiscal year 2006.

18 53. Kaufman has been a member of the Nominating and Governance Committee
19 since fiscal year 2005.

20 54. Defendants Levy, Morton, Barnholt, Schroeder, Elkus, Bingham and Kaufman
21 are collectively referred to hereinafter as the "Nominating and Governance Committee
22 Defendants." According to KLA's Nominating and Governance Committee Charter, the
23 purpose of the Nominating and Governance Committee is to, *inter alia*, "provide assistance to
24 the Board of Directors in fulfilling its responsibility to its stockholders, potential stockholders
25 and investment community by":

- 26 a. "Identifying individuals qualified to become directors and
27 selecting, or recommending that the Board of Directors select, the
28 candidates for all directorships to be filled by the Board of
Directors or by the stockholders."

- 1 b. “Developing and recommending to the Board of Directors a set of
2 corporate governance principles applicable to the KLA-Tencor
3 Corporation.”
- 4 c. “Overseeing the evaluation of the Board of Directors and ensuring
5 that the Board of Directors is properly constituted to meet its
6 fiduciary obligations to the Corporation and its stockholders and
7 that the Corporation has and follows appropriate governance
8 standards.”
- 9 d. “Otherwise taking a leadership role in shaping the corporate
10 governance of the Corporation.”
- 11 55. The Nominating and Governance Committee Charter states that the
12 responsibilities and duties of the Nominating and Governance Committee include the duties to:
- 13 a. “Evaluate the current composition, organization and governance of
14 the Board of Directors and its committees, determine future
15 requirements and make recommendations to the Board of Directors
16 for approval.”
- 17 b. “Identify individuals believed to be qualified as candidates to serve
18 on the Board of Directors and select, or recommend that the Board
19 of Directors select, the candidates for all directorships to be filled
20 by the Board of Directors or by the stockholders at an annual or
21 special meeting.”
- 22 c. “Review and make recommendations to the full Board of
23 Directors, or determine, whether members of the Board should
24 stand for re-election.”
- 25 d. “Conduct all necessary and appropriate inquiries into the
26 backgrounds and qualifications of possible candidates.”
- 27 e. “Consider questions of independence and possible conflicts of
28 interest of members of the Board of Directors and executive
 officers.”
- f. “Review and make recommendations, as the Committee deems
 appropriate, regarding the composition and size of the Board of
 Directors in order to ensure the Board has the requisite expertise
 and its membership consists of persons with sufficiently diverse
 and independent backgrounds.”
- g. “Evaluate and recommend termination of membership of
 individual directors in accordance with the Board of Directors’
 governance principles, for cause or for other appropriate reasons.”
- h. “Recommend members of the Board of Directors to serve on the
 committees of the Board, giving consideration to the criteria for
 service on each committee as set forth in the charter for such
 committee, as well as to any other factors the Committee deems
 relevant, and where appropriate, make recommendations regarding

the removal of any member of any committee.”

- i. “Develop and recommend to the Board of Directors a set of corporate governance principles and keep abreast of developments with regard to corporate governance to enable the Committee to make recommendations to the Board of Directors in light of such developments as may be appropriate.”
- j. “Report regularly to the Board of Directors (i) following meetings of the Committee, (ii) with respect to such other matters as are relevant to the Committee’s discharge of its responsibilities and (iii) with respect to such recommendations as the Committee may deem appropriate.”

56. The Nominating and Governance Committee did not meet during the 2001 and 2002 fiscal years. During fiscal years 2003, 2004, 2005 and 2006, the Nominating and Governance Committee met two, three, five and four times, respectively.

(vi) The Additional Outside Director Defendant: Tompkins

57. Jon D. Tompkins (“Tompkins”) served as a director of KLA from April 1997 with his resignation on December 21, 2006. Tompkins served as Chairman of the Board from July 1998 to June 1999 and as CEO of the Company from May 1997 to July 1998. According to the Company’s 2006 Form 10-K, Tompkins also served as a member of the Stock Option Committee from mid-1997 until mid-1999. Tompkins signed KLA’s false and misleading SEC filings during the Class Period, including the 2001, 2002, 2003, 2004 and 2005 Form 10-Ks. Tompkins is a citizen of the State of California.

58. Defendants Wallace, Schroeder, Urbanek, Marks, Barnholt, Bond, Bingham, Elkus, Morton, Kaufman, Levy and Tompkins are collectively referred hereinafter as the “Director Defendants.” During the Class Period, KLA’s Board of Directors was responsible for the oversight and monitoring of (a) the integrity of the financial statements; (b) the Company’s compliance with legal and regulatory requirements; (c) the independent auditor’s qualifications, independence and performance; and (d) the Company’s internal accounting and financial controls. The Board had final decision-making authority regarding compensation and determined the compensation to be provided to executive officers and directors of the Company, including salaries, retainers, stock compensation and loans, and all salary, bonus and

1 stock compensation to all employees. In addition, the Board was the administrator of KLA's
2 stock option plans. In that capacity, the Board had the authority, among other things, to
3 determine the terms and conditions of the awards granted under the stock option plans, which
4 includes establishing the exercise price of the stock options, deciding who will receive stock
5 options and determining number of stock options awarded to each recipient. Members of the
6 Board committees, including the Audit Committee, Compensation Committee and Nominating
7 Governance Committee, reported to the Board. In addition to its responsibilities to KLA, the
8 Board had fiduciary responsibilities to its stockholders, potential stockholders and the
9 investment community.

10 59. Wallace, Schroeder, Dickerson, Kispert, Hall, Boehlke, Nichols, Urbanek,
11 Marks, Barnholt, Bond, Bingham, Elkus, Morton, Kaufman, Levy and Tompkins are
12 collectively referred to herein as the "Individual Defendants." Because of the Individual
13 Defendants' positions within the Company, they had access to adverse undisclosed material
14 information about KLA's financial condition, earnings and expenses, officer and director
15 compensation, stock option grants and management integrity. They were privy to such
16 undisclosed information from internal corporate documents, communications with other officers
17 and employees of the Company and attendance at, and documents received during, meetings of
18 management, the Board of Directors, the Stock Option Committee, the Compensation
19 Committee, the Audit Committee and/or the Nominating Committee. They each knew or were
20 deliberately reckless in not knowing of the adverse material facts which rendered the statements
21 alleged herein false and misleading.

22 60. The Individual Defendants, as officers and/or directors of the Company, had a
23 duty to disseminate complete, accurate and truthful information about KLA's financial
24 condition, earnings and expenses, stock option grants, officer and director compensation and
25 management integrity. The Individual Defendants had a duty to promptly correct any public
26 statements issued by KLA that had become false and misleading. The Individual Defendants
27 were involved in the drafting, producing, reviewing and/or dissemination of the false and
28

1 misleading statements alleged herein.

2 61. Because of their positions, their ability to exercise power and influence with
3 respect to KLA's course of conduct and their access to material inside information about KLA,
4 the Individual Defendants were, at the time of the wrongs alleged herein, controlling persons
5 within the meaning of Section 20(a) of the Exchange Act.

6 62. It is appropriate to treat the Individual Defendants as a group for pleading
7 purposes and to presume that the false, misleading and/or incomplete information conveyed in
8 the Company's public filings, press releases and other publications as alleged herein are the
9 collective action of the Individual Defendants identified above.

10 **IV. CLASS ACTION ALLEGATIONS**

11 63. Lead Plaintiffs bring this action as a class action pursuant to Rule 23(a) and
12 (b)(3) of the Federal Rules of Civil Procedure on behalf of a class consisting of all persons and
13 entities who purchased KLA securities during the Class Period and were damaged thereby
14 ("Class"). Excluded from the Class are defendants herein, officers and directors of KLA,
15 members of their immediate families and the heirs, successors or assigns of any of the
16 foregoing.

17 64. The members of the Class are so numerous that joinder of all members is
18 impracticable. While the exact number of Class members is unknown to Lead Plaintiffs at this
19 time and can only be ascertained through appropriate discovery, Lead Plaintiffs believe there
20 are, at a minimum, thousands of members of the Class. According to the 2006 Form 10-K,
21 there were 199,725,957 shares of common stock outstanding as of December 31, 2006, which
22 securities traded actively in an open and efficient market on the NASDAQ National Market
23 under the symbol "KLAC."

24 65. Common questions of law and fact exist as to all members of the Class and
25 predominate over any questions affecting solely individual members of the Class. The
26 following are questions of law and fact common to the Class:

- 27 • whether defendants engaged in acts or conduct in violation of federal securities
28

1 laws as alleged herein;

- 2 • whether the misrepresentations were material;
- 3 • whether the misrepresentations contained in the proxy statements were
- 4 essentially linked to the votes sought by the proxy;
- 5 • whether KLA issued false and misleading financial statements and information
- 6 about stock option expenses, officer and director compensation and KLA
- 7 financial condition during the Class Period;
- 8 • whether the Individual Defendants caused KLA to issue false and misleading
- 9 financial statements and information about stock options, officer and director
- 10 compensation and KLA financial condition during the Class Period;
- 11 • whether the Individual Defendants falsified or permitted the falsification of
- 12 documents relating to stock option grants;
- 13 • whether defendants acted knowingly or with deliberate recklessness in issuing
- 14 false and misleading financial statements and information about stock options,
- 15 officer and director compensation and KLA financial condition;
- 16 • whether defendants improperly manipulated the terms of the stock options
- 17 granted to the Individual Defendants and others and misled investors regarding
- 18 such terms and KLA's financial condition;
- 19 • whether defendants engaged in a scheme to defraud by manipulating the terms of
- 20 stock options granted to the Individual Defendants and others;
- 21 • whether the market prices of KLA securities during the Class Period were
- 22 artificially inflated because of defendants' conduct complained of herein;
- 23 • whether the members of the Class have sustained damages and, if so, what is the
- 24 proper measure of damages; and
- 25 • what form of equitable relief should be awarded.

26 66. Lead Plaintiffs' claims are typical of the claims of the other members of the
27 Class and the other members of the Class sustained damages arising out of defendants'

1 wrongful conduct in violation of federal law as complained of herein.

2 67. Lead Plaintiffs will fairly and adequately protect the interests of the members of
3 the Class and have retained counsel competent and experienced in class actions and securities
4 litigation. Lead Plaintiffs have no interests antagonistic to, or in conflict with, those of the
5 Class.

6 68. A class action is superior to other available methods for the fair and efficient
7 adjudication of the controversy since joinder of all the members of the Class is impracticable.
8 Furthermore, because the damages suffered by the individual Class members may be relatively
9 small, the expense and burden of individual litigation makes it impracticable for the Class
10 members individually to redress the wrongs done to them. There will be no difficulty in the
11 management of this action as a class action.

12 69. Lead Plaintiffs will rely, at least in part, upon the presumption of reliance
13 established by the fraud-on-the-market doctrine in that:

- 14 • defendants made public misrepresentations and omissions during the Class
- 15 Period;
- 16 • the omissions and misrepresentations were material;
- 17 • the Company's securities traded on the NASDAQ, an efficient and open
- 18 exchange;
- 19 • the misrepresentations and omissions alleged would tend to induce a reasonable
- 20 investor to misjudge the value of the Company's securities;
- 21 • Lead Plaintiffs and the other members of the Class purchased their KLA stock
- 22 between the time defendants failed to disclose or misrepresented material facts
- 23 and the time the true facts were disclosed, without knowledge of the omitted or
- 24 misrepresented facts;
- 25 • as a regulated issuer, KLA submitted regular public filings to the SEC, such as
- 26 on Forms 10-K and 10-Q; and
- 27 • the Company's stock was followed by numerous financial analysts, including
- 28

1 Cowen & Company and Goldman Sachs & Co. Thus, the Company's stock
2 reflected the effect of information disseminated into the market.

3 70. Based upon the foregoing, all purchasers of KLA securities during the Class
4 Period suffered similar injury, including injury through their purchase of the securities at
5 artificially inflated prices, and a presumption of reliance applies.

6 **V. BACKGROUND**

7 **A. CONFIDENTIAL WITNESSES**

8 71. The allegations are supported by, among other things, the information provided
9 by Confidential Witnesses who worked in various positions within the Company organization
10 prior to and/or during the Class Period:

11 (a) Lead Plaintiffs are informed and believe that Confidential Witness No. 1
12 ("CW #1") worked for the Company from 1995 to early 2003 as a financial analyst, director of
13 finance and division controller. As division controller, CW #1 often had to prepare documents
14 for the Board of Directors and would "occasionally prepare the CFO's presentation to the
15 Operating Committee and the Board of Directors."

16 (b) Lead Plaintiffs are informed and believe that Confidential Witness No. 2
17 ("CW #2") worked as director of staffing and reported to Tom Coffey during 2002.

18 (c) Lead Plaintiffs are informed and believe that Confidential Witness No. 3
19 ("CW #3") worked as a senior director of finance from 2001 until 2002.

20 (d) Lead Plaintiffs are informed and believe that Confidential Witness No. 4
21 ("CW #4") worked for the Company from 1993 to 2004 in various human resources positions.
22 CW #4 assisted with the preparation of data for obtaining the approval of new hire or
23 promotion-related stock option grants. In this capacity, CW #4 helped prepare quarterly
24 spreadsheets containing information such as the type of grant (*i.e.*, new hire, employee
25 promotion, annual (focal) performance review or retention), employee name, employee hire
26 date, employee title and number of shares being recommended.

27 (e) Lead Plaintiffs are informed and believe that Confidential Witness No. 5
28

1 ("CW #5") worked for the Company as an executive assistant until late 2004 and participated in
2 preparing agendas for executive meetings, inviting attendees to such meetings and reviewing
3 meeting minutes. CW #5 stated that he/she prepared agendas for some of the Stock Option
4 Committee meetings.

5 (f) Lead Plaintiffs are informed and believe that Confidential Witness No. 6
6 ("CW #6") worked for the Company from 1999 to 2005 as a director of stock and retirement
7 services, as a staff benefits analyst and as a benefits manager. CW #6 reported to Joy Nyberg
8 ("Nyberg"), the director of Compensation and Benefits.

9 (g) Lead Plaintiffs are informed and believe that Confidential Witness No. 7
10 ("CW #7") worked for the Company from 2001 to 2002 as compensation manager. CW #7 was
11 responsible for benefits and pay for all U.S. employees of the Company and reported directly to
12 Nyberg, the director of Compensation and Benefits.

13 (h) Lead Plaintiffs are informed and believe that Confidential Witness No. 8
14 ("CW #8") worked for the Company from late 2003 through summer 2005 in operations and
15 later in finance.

16 **B. KLA'S STOCK OPTION PLANS**

17 72. Companies may grant stock options to its officers, directors and employees only
18 under a written stock option plan filed with the SEC and disclosed to the public. Companies
19 must comply with the terms of their written stock option plans.

20 73. According to KLA's filings with the SEC, it appears that KLA granted stock
21 options during the Class Period pursuant to at least the following four plans: (a) the Restated
22 1982 Stock Option Plan, which applies to employees, consultants, officers and inside directors;
23 (b) the 1998 Outside Director Option Plan, which applies to outside directors, (c) the 2000
24 Nonstatutory Stock Option Plan, which applies to employees and consultants; and (d) the 2004
25 Equity Incentive Plan, which applies to employees, including officers and directors. *The*
26 *backdated option grants violated the terms of at least three of these plans.*

27

28

1 **1. The Restated 1982 Stock Option Plan**

2 74. The Restated 1982 Stock Option Plan ("1982 Plan"), as amended on November
3 18, 1996, was originally adopted by KLA Instruments Corporation in 1981. *See* KLA
4 Instrument Corporation's SEC Form S-8, filed on March 7, 1997. The 1982 Plan was attached
5 as Exhibit 10.10 to KLA's Form 10-K for the fiscal year ended June 30, 2001 and was operative
6 through October 18, 2004. *See* Form 10-Q filed November 3, 2004.

7 75. Pursuant to Section 3.1 ("Administration by the Board") of the 1982 Plan, the
8 Plan is administered by the "Board" or "any duly appointed Committee of the Board." Section
9 3.4 ("Powers of the Board") of the 1982 Plan provides, in part, that, "*subject to the provisions*
10 *of the Plan*, the Board shall have the full and final power and authority, in its sole discretion"
11 (a) to determine who is awarded an option and the time at which the person is awarded an
12 option; (b) to determine the number of shares of stock awarded pursuant to each option; (c) to
13 designate options as Incentive Stock Options or Nonstatutory Stock Options; (d) to determine
14 the fair market value of shares of stock; and (e) to determine the terms, conditions and
15 restrictions of each option and any shares acquired upon exercise of an option, including, but
16 not limited to, the exercise price of the option. (Emphasis added.)

17 76. Section 5.1 ("Persons Eligible for Options") states that employees, consultants
18 and directors are the only persons eligible to receive options under the 1982 Plan. This section
19 also states that directors who are not employees are ineligible to be granted options under the
20 1982 Plan.

21 77. In addition, Section 5.2 ("Option Grant Restrictions") states that "[a]n Option
22 granted to a prospective Employee, Consultant or Director upon condition that such person
23 commence Service with the Participating Company Group shall be deemed granted effective on
24 the date such person's Service commences, with an exercise price determined as of such date in
25 accordance with Section 6.1."

26 78. Section 6.1 ("Exercise Price") of the 1982 Plan states that "[t]he exercise price
27 for each Option shall be established in the sole discretion of the Board; provided, however, that
28

1 (a) *no Option shall have an exercise price per share less than the Fair Market Value of a*
2 *share of Stock on the effective date of grant of the Option* and (b) no Incentive Stock Option
3 granted to a Ten Percent Owner Optionee shall have an exercise price per share less than one
4 hundred ten percent (110%) of the Fair Market Value of a share of Stock on the effective date
5 of grant of the Option.” (Emphasis added.)

6 **2. The 1998 Outside Director Option Plan**

7 79. On November 17, 1998, KLA’s shareholders approved the 1998 Outside
8 Director Option Plan (“1998 Outside Director Plan”). The 1998 Outside Director Plan was
9 attached as Exhibit 10.1 to KLA’s Form 10-K for the fiscal year ended June 30, 2001 and was
10 operative at all times during the Class Period.

11 80. Under Section 1 (“Purposes of the Plan”) of the 1998 Outside Director Plan,
12 options granted under the Plan are nonstatutory stock options.

13 81. Section 4(a) (“Discretionary Plan”) of the 1998 Outside Director Plan states that
14 “[t]he Board (or its committee) shall have the authority, in its discretion, to make discretionary
15 grants of Options hereunder to Outside Directors and to specify the terms and conditions of
16 such discretionary Option grants.” “Outside Directors” is defined under Section 2(n) as a
17 “Director who is not an employee.” Section 4(b) (“Automatic Grants”) provides for automatic
18 grants on the date on which such person first becomes an Outside Director (“First Option”) and
19 thereafter annually on the day of the Company’s annual shareholder meetings (“Subsequent
20 Option”).

21 82. Section 4(b)(iii)(C) of the 1998 Outside Director Plan provides that “the exercise
22 price per Share shall be 100% of the Fair Market Value per Share on the date of the grant of the
23 First Option.” Similarly, Section 4(b)(iv)(C) states that “the exercise price per Share shall be
24 100% of the Fair Market Value per Share on the date of the grant of the Subsequent Option.”
25 Section 4(b)(iv)(D) provides that the “Subsequent Option shall become exercisable as to 100%
26 of the Shares on the date of the grant.”

1 **3. The 2004 Equity Incentive Plan**

2 83. On October 18, 2004, KLA's shareholders approved the Company's 2004 Equity
3 Incentive Plan ("2004 Equity Incentive Plan"), which replaced the 1982 Plan and the 2000
4 Nonstatutory Stock Option Plan, and supplemented the 1998 Outside Director Plan. *See*
5 Appendix A to KLA's September 9, 2004 Schedule 14A Proxy Statement. *See* Q1FY05 Form
6 10-Q filed November 3, 2004.

7 84. According to Section 1 ("Purposes of the Plan") of the 2004 Equity Incentive
8 Plan, the 2004 Equity Incentive Plan provides for the grant of Incentive Stock Options,
9 Nonstatutory Stock Options, Restricted Stock, Stock Appreciation Rights, Performance Shares,
10 Performance Units and Deferred Stock Units.

11 85. Pursuant to Section 5 ("Eligibility") of the 2004 Equity Incentive Plan,
12 "Restricted Stock, Performance Shares, Performance Units, Stock Appreciation Rights,
13 Deferred Stock Units and Non Statutory Stock Options may be granted to Service Providers.
14 Incentive Stock Options may be granted only to Employees." "Service Providers" are defined
15 in Section 2(rr) of the Plan as "an Employee, Consultant or Director."

16 86. Section 2(a) ("Definitions") of the 2004 Equity Incentive Plan defines the Plan
17 "Administrator" as "the Board or any of its Committees as shall be administering the Plan, in
18 accordance with Section 4 of the Plan." Pursuant to Section 4(a)(i) ("Administration of the
19 Plan") of the 2004 Equity Incentive Plan, "[t]he Plan may be administered by different
20 Committees with respect to different groups of Service Providers." In addition, Section 4(a)(iv)
21 states that "the Plan shall be administered by (A) the Board or (B) a Committee, which
22 committee shall be constituted to satisfy Applicable Laws."

23 87. Under Section 4(b) ("Powers of the Administrator") of the 2004 Equity Incentive
24 Plan, the Board or its Committee has the authority, "*subject to the provisions of the plan,*"
25 among other things, (a) "to determine the Fair Market Value of the Common Stock, in
26 accordance with Section 2(u) of the Plan"; (b) "to select Service Providers to whom Awards
27 may be granted;" (c) "to determine the number of shares of Common Stock or equivalent units
28

1 to be covered by each Award granted;” and (d) “to determine the terms and conditions, *not*
2 *inconsistent with the terms of the Plan*, of any award grant... [including] the exercise price.”

3 88. Section 9(b) (“Option Exercise Price”) of the 2004 Equity Incentive Plan states
4 that “[t]he per share exercise price for the Shares to be issued pursuant to exercise of an
5 Option shall be determined by the Administrator and shall be no less than 100% of the Fair
6 Market Value per share on the date of the grant.” (Emphasis added.)

7 89. Section 9(c) (“No Repricing”) of the 2004 Equity Incentive Plan provides that
8 “[t]he exercise price for an Option may not be reduced without the consent of the Company’s
9 stockholders. This shall include, without limitation, a repricing of the Option as well as an
10 Option exchange program whereby the Participant agrees to cancel an existing Option in
11 exchange for an Option, SAR or other Award.”

12 VI. SUBSTANTIVE ALLEGATIONS

13 90. Defendants violated the federal securities laws in several ways. First, defendants
14 issued false and misleading statements and controlled persons who issued false and misleading
15 statements in violation of Rule 10b-5(b), 14(a) and 20(a) of the Exchange Act. The false and
16 misleading statements are summarized in ¶¶91-140, 165-213, 221-235 below. Second,
17 defendants each committed manipulative or deceptive acts in furtherance of the fraudulent
18 scheme in violation of Rule 10b-5(a) and (c) and 20(a). These manipulative and deceptive acts
19 are summarized in ¶¶242-265 below. Third, defendants engaged in insider trading in violation
20 of Sections 10(b) and 20A. This trading is summarized in ¶¶309-313.

21 A. DEFENDANTS’ FALSE AND MISLEADING STATEMENTS

22 91. During the Class Period, defendants issued a series of false and misleading
23 statements in violation of Sections 10(b), 14(a) and 20(a) of the Exchange Act and Rule 10b-5.
24 These statements fall within several categories, discussed more fully below. First, defendants
25 issued false and misleading statements regarding the Company’s financials. Second, defendants
26 issued false and misleading statements regarding the terms and value of the options granted to
27 officers, directors and employees. Third, defendants issued false and misleading statements
28

1 regarding the Company's internal controls relating to stock option grants and related financial
2 reporting.

3 **1. False and Misleading Financial Statements**

4 **(a) The Misleading Financials**

5 92. On April 18, 2001, the Company issued a press release entitled "KLA-Tencor
6 Reports Operating Results for Third Fiscal Quarter 2001," which ended March 31, 2001. The
7 press release, which quotes Schroeder, states in part:

8 SAN JOSE, Calif., Apr. 18, 2001 - KLA-Tencor Corporation today announced its
9 operating results for the third fiscal quarter ended March 31, 2001. Revenues
10 were \$529 million, a 28 percent increase from \$413 million in the March 2000
11 quarter, and an 8 percent decrease from the previous quarter. Compared to the
12 March 2000 quarter, net income increased 25 percent to \$91 million and earnings
per share increased from \$0.38 to \$0.48. On a quarter-to-quarter basis, net income
declined 16 percent compared to \$109 million, or \$0.57 per share, in the
December 2000 quarter.

13 * * *

14 The Company ended the quarter with over six months backlog at current shipping
15 levels. Gross margins declined from 57 percent last quarter to 54 percent, due
16 primarily to lower production volumes and new product introduction costs. Total
17 fixed costs decreased to \$174 million from \$191 million in the last fiscal quarter.
18 Cash and investments increased by \$119 million during the quarter to \$936
19 million due to income from operations and reduced working capital requirements.

20 93. On May 14, 2001, the Company filed its quarterly report on Form 10-Q for its
21 third quarter of fiscal 2001 with the SEC ("Q3FY01 Form 10-Q"), which was signed by
22 Kispert. The Q3FY01 Form 10-Q contained the following false and misleading statements:
23 For the three-month period ended March 31, 2001, the Company reported net income of
24 \$91,410,000 (\$0.48 per diluted share) and expenses of \$416,437,000.

25 94. On July 31, 2001, the Company issued a press release entitled "KLA-Tencor
26 Reports Operating Results For Fiscal Year 2001," which ended on June 30, 2001. The press
27 release, which quotes Schroeder, states in relevant part:

28 KLA-Tencor Corp. (Nasdaq: KLAC) today announced its operating results for the
fourth quarter and fiscal year ended June 30, 2001. The company also reported its
fourth quarter transition from historical accounting methods to the new methods
required by the Securities and Exchange Commission Staff Accounting Bulletin
No. 101 (SAB 101). Reflecting this transition, historical results are provided first,
followed by the SAB 101 results.

On an historical basis, revenues for the June 2001 quarter were \$462 million, a 4

1 percent decrease from the June 2000 quarter and a 13 percent decrease from the
2 March 2001 quarter. On the same basis, net income was \$56 million or \$0.29 per
share versus \$92 million or \$0.47 per share in the June 2000 quarter, and \$91
million or \$0.48 per share for the March 2001 quarter.

3 For fiscal 2001, historical basis revenue reached a record \$2.1 billion, a 40
4 percent increase over fiscal 2000 revenue of \$1.5 billion. Net income before
applying SAB 101 also reached record levels of \$363 million or \$1.87 per share-a
5 43 and 42 percent increase respectively over last year's net income of \$254
million or \$1.32 per share.

* * *

6 On a SAB 101 basis, fourth quarter revenue for fiscal 2001 was \$603 million and
7 net income was \$130 million or \$0.67 per share. SAB 101 revenue for fiscal 2001
was \$2.1 billion, while net income for the year was \$373 million or \$1.93 per
8 share before a cumulative impact of \$306 million or \$1.59 per share from the
transition to SAB 101 accounting principles. This change further resulted in
9 cumulative deferred revenue of \$655 million as of June 30, 2001 versus \$661
million as of June 30, 2000.

10 95. On September 21, 2001, the Company filed its 2001 Form 10-K, which was
11 signed by Levy, Schroeder, Kispert, Barnholt, Bingham, Bond, Elkus, Tompkins and Urbanek.
12 The 2001 Form 10-K included (a) certifications by Levy, Schroeder, Kispert, Barnholt,
13 Bingham, Bond, Elkus, Morton, Tompkins and Urbanek stating that, "[p]ursuant to the
14 requirements of the Securities Exchange Act of 1934, this report has been signed below by the
15 following persons on behalf of the registrant and in the capacities and on the dates indicated;"
16 and (b) a certification by Levy stating that, "[p]ursuant to the requirements of Section 13 or
17 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be
18 signed on its behalf by the undersigned, thereunto duly authorized on September 21, 2001."
19 This 2001 Form 10-K contained the following statements, which were false and misleading:

20 (a) For fiscal 2001, the Company reported net income of \$66,683,000 (\$0.34
21 per diluted share) and expenses of \$1,645,289,000.

22 (b) For the three-month period ended June 30, 2001, KLA reported net
23 income of \$116,104,000 (\$0.47 per diluted share).

24 (c) "Stock-Based Compensation Plans KLA-Tencor accounts for its
25 employee stock option plans and employee stock purchase plan in accordance with provisions
26 of APB 25, 'Accounting for Stock Issued to Employees.' KLA-Tencor provides additional *pro*
27 *forma* disclosures required by SFAS 123, 'Accounting for Stock-Based Compensation' (see
28

1 Note 6).” The 2001 Form 10-K reported a *pro forma* net loss for fiscal 2001 of \$27,013,000
2 (loss of \$0.15 per diluted share).¹

3 96. On October 18, 2001, the Company issued a press release entitled “KLA-Tencor
4 Reports First Quarter Operating Results for Fiscal 2002,” which ended September 30, 2001.
5 The press release, which quotes Schroeder, states in part:

6 KLA-Tencor Corp. (Nasdaq: KLAC) today announced its operating results for the
7 first quarter of fiscal 2002, ended September 30, 2001. Revenue was \$503
8 million, down 17 percent from the previous quarter's revenue of \$603 million.
9 This was a 31 percent increase from the \$383 million in revenue for the
10 September 2000 fiscal quarter. Income after tax for the September 2001 quarter
11 was \$86 million, or \$0.44 per share, compared to \$29 million, or \$0.15 per share
12 in the corresponding quarter a year ago before the cumulative effect of a change
13 in accounting principles.

10 * * *

11 Gross margins for the current quarter were 51.4 percent versus 55.3 percent in the
12 prior quarter-primarily due to unfavorable overhead absorption based on reduced
13 business levels during the quarter and a higher percentage of service revenue.
14 Operating expenses were \$154 million, a decrease of \$18 million from the June
15 2001 quarter.

14 97. On November 14, 2001, the Company filed its quarterly report on Form 10-Q for
15 the first quarter of 2002 with the SEC (“Q1FY02 Form 10-Q”), which was signed by Kispert.
16 The Q1FY02 Form 10-Q contained the following false and misleading statements: For the
17 three-month period ended September 30, 2001, the Company reported net income of
18 \$86,465,000 (\$0.44 per diluted share) and expenses of \$398,539,000.

19 98. On January 23, 2002, the Company issued a press release entitled “KLA-Tencor
20 Reports Second Quarter Operating Results for Fiscal 2002.” The press release, which quotes
21 Schroeder, states in part:

22 KLA-Tencor Corp. (Nasdaq: KLAC) today announced its operating results for its
23 second fiscal quarter ended December 31, 2001. Consistent with the company's
24 earlier guidance, KLA-Tencor reported after tax net income of \$49 million or
25 \$0.25 per share on revenue of \$404 million. Compared to the same period one
26 year ago, when the company reported net income of \$78 million or \$0.41 per
27 share on revenue of \$501 million, revenue and net income for the second quarter
28 ended December 31, 2001 were down 19 and 37 percent respectively. On a
sequential quarter basis, revenue and net income declined 20 and 43 percent

¹ As explained more fully in ¶¶144-146 below, SFAS 123 required *pro forma* disclosures of net income and net income per share.

1 respectively from the September 2001 quarter.

2 * * *

3 Gross margins for the current quarter were 50.1 percent versus 51.4 percent in the
4 prior quarter-primarily due to a higher percentage of service revenue and the
larger percentage decrease in shipments versus manufacturing overhead expense.
Operating expenses were \$146 million, \$8 million lower than the September 2001
quarter.

5 99. On December 26, 2001, KLA filed a Form S-8 Registration Statement with the
6 SEC, which registered securities to be issued under the Company's Employee Benefit Plan. In
7 this Registration Statement, KLA incorporated by reference the following documents which
8 contained false and misleading statements (a) the 2001 Form 10-K; (b) the Q1FY02 Form 10-Q;
9 and (c) the 2001 Proxy Statement. This Registration Statement also stated that all documents
10 subsequently filed by the Registrant pursuant to Sections 13(a), 13(c), 14 and 15(d) of the
11 Exchange Act, prior to the filing of a post-effective amendment to this Registration Statement,
12 shall be deemed to be incorporated by reference in this Registration Statement from the date of
13 filing of such documents.

14 100. On February 13, 2002, the Company filed its quarterly report on Form 10-Q for
15 the period ended December 31, 2001 with the SEC ("Q2FY02 Form 10-Q"), which was signed
16 by Kispert. The Q2FY02 Form 10-Q contained the following false and misleading statements:
17 For the three-month period ended December 31, 2001, the Company reported net income of
18 \$49,048,000 (\$0.25 per diluted share) and expenses of \$347,868,000. For the six-month period
19 ended December 31, 2001, the Company reported net income of \$135,513,000 (\$0.70 per
20 diluted share) and expenses of \$746,407,000.

21 101. On April 18, 2002, the Company issued a press release entitled "KLA-Tencor
22 Reports Third Quarter Operating Results for Fiscal 2002." The press release, which quotes
23 Schroeder, states in part:

24 KLA-Tencor Corp. (Nasdaq: KLAC) today announced operating results for its
25 third fiscal quarter ended March 31, 2002. KLA-Tencor reported after tax net
26 income of \$34 million or \$0.17 per fully diluted share on revenues of \$357
27 million. As expected, compared to the same period one year ago, the current
quarter's revenues and net income were down 42 and 75 percent respectively. On
a quarter over quarter basis, revenues and net income declined 12 and 30 percent
28 respectively from the December 2001 quarter.

EXHIBIT 4
Part 2 of 5

* * *

1 Gross margins for the current quarter were 49.0 percent versus 50.1 percent in the
2 prior quarter largely due to a higher percentage of service revenue versus system
3 revenue. Operating expenses were \$138 million, \$8 million lower than the
4 December 2001 quarter. Engineering expenses declined \$2.6 million and sales,
5 marketing, and administration decreased \$5.6 million versus the previous quarter.

6 102. On May 13, 2002, the Company filed its quarterly report on Form 10-Q for the
7 period ended March 31, 2002 with the SEC ("Q3FY02 Form 10-Q"), which was signed by
8 Kispert. The Q3FY02 Form 10-Q contained the following false and misleading statements: For
9 the three-month period ended March 31, 2002, the Company reported net income of
10 \$34,149,000, (\$0.17 per diluted share) and expenses of \$320,011,000. For the nine-month
11 period ended March 31, 2002, the Company reported net income of \$169,662,000 (\$0.86 per
12 diluted share) and expenses of \$1,066,418,000.

13 103. On July 30, 2002, the Company issued a press release entitled "KLA-Tencor
14 Reports Operating Results for Fiscal Year 2002." The press release, which quotes Schroeder,
15 states in part:

16 KLA-Tencor Corporation (Nasdaq: KLAC) today announced its operating results
17 for its fourth quarter and 2002 fiscal year, which ended on June 30, 2002. The
18 company reported \$47 million in net income and earnings per share of \$0.23 on
19 revenues of \$373 million for the fourth quarter. In the fourth quarter of fiscal
20 year 2001, by comparison, KLA-Tencor reported net income of \$130 million and
21 earnings per share of \$0.67 on revenues of \$603 million. In a quarter-over-
22 quarter comparison with the March 2002 fiscal third quarter, net income rose 36
23 percent from \$34 million, earnings per share increased 35 percent from \$0.17, and
24 revenue rose 4.5 percent from \$357 million. For the full fiscal year 2002, KLA-
25 Tencor reported net income of \$216 million and earnings per share of \$1.10 on
26 revenue of \$1.64 billion. This compares with net income of \$373 million and
27 earnings per share of \$1.93 (prior to the cumulative effect of the implementation
28 of SAB 101 accounting principles) on revenue of \$2.1 billion for the 2001 fiscal
29 year.

* * *

30 Gross margins for the current quarter were 50.1 percent versus 49.0 percent in the
31 prior quarter. Operating expenses were \$140 million, or 37.5% of revenue. Cash
32 and marketable securities were \$1.33 billion, an increase of \$117 million from the
33 previous quarter.

34 104. On September 20, 2002, the Company filed its 2002 Form 10-K, which was
35 signed by Levy, Schroeder, Kispert, Barnholt, Bingham, Bond, Elkus, Tompkins and Urbanek.
36 The 2002 Form 10-K contained the following statements, which were false and misleading:

1 (a) For fiscal 2002, the Company reported net income of \$216,166,000
2 (\$1.10 per diluted share) and expenses of \$1,392,389,000.

3 (b) For the three-month period ended June 30, 2002, KLA reported net
4 income of \$47,223,000 (\$0.23 per diluted share).

5 (c) The same representation regarding the application of APB No. 25 as
6 contained in the 2001 Form 10-K. The 2002 Form 10-K reported *pro forma* net income figure
7 for fiscal 2002 of \$92,364,000 (\$0.47 per diluted share).

8 (d) Certifications by Schroeder and Kispert stating that:

9 I, [], certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to
10 Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report of KLA-
11 Tencor Corporation on Form 10-K for the fiscal year ended June 30, 2002 fully
12 complies with the requirements of Section 13(a) or 15(d) of the Securities
13 Exchange Act of 1934 and that information contained in such Annual Report on
Form 10-K fairly presents in all material respects the financial condition and
results of operations of KLA-Tencor Corporation.

14 105. On September 27, 2002, KLA filed a Form S-8 Registration Statement, which
15 registered securities to be issued under the Company's Employee Benefit Plan. In this
16 Registration Statement, KLA incorporated by reference the following documents which
17 contained false and misleading statements: (a) 2002 Form 10-K; and (b) 2002 Proxy Statement.
18 This Registration Statement also stated that all documents subsequently filed by the Registrant
19 pursuant to Sections 13(a), 13(c), 14 and 15(d) of the Exchange Act, prior to the filing of a post-
20 effective amendment to this Registration Statement, shall be deemed to be incorporated by
21 reference in this Registration Statement from the date of filing of such documents.

22 106. On October 22, 2002, the Company issued a press release entitled "KLA-Tencor
23 Posts \$51 Million in Net Income for Its First Fiscal Quarter 2003." The press release, which
24 quotes Schroeder, states in part:

25 KLA-Tencor Corp. (Nasdaq: KLAC) today announced its operating results for its
26 first quarter of fiscal 2003, ended September 30, 2002. The company posted net
27 income of \$51 million and earnings per share of \$0.26 on revenues of \$376
28 million. Revenue, net income and earnings per share were all up slightly from the
prior fiscal quarter's results of \$374 million, \$47 million and \$0.23 per share
respectively-due in part to a one-time net pre-tax gain of \$9 million related to the
sale of technology offset by charges related to facilities consolidations.

1 Reflecting the current business environment, net income and revenue were down
2 on a year-over-year basis from the levels of the first fiscal quarter of 2002 when
the company posted net income of \$86 million on revenues of \$503 million.

3 107. On November 13, 2002, the Company filed its quarterly report on Form 10-Q for
4 the period ended September 30, 2002 with the SEC ("Q1FY03 Form 10-Q"), which was signed
5 by Schroeder and Kispert. This Q1FY03 Form 10-Q contained the following false and
6 misleading statements:

7 (a) For the three-month period ended September 30, 2002, the Company
8 reported net income of \$51,265,000 (\$0.26 per diluted share) and expenses of \$318,236,000.

9 (b) SOX certifications by Schroeder and Kispert stating that:

10 I, [] certify that:

11 1. I have reviewed this quarterly report on Form 10-Q of KLA-Tencor
12 Corporation;

13 2. Based on my knowledge, this quarterly report does not contain any untrue
14 statement of a material fact or omit to state a material fact necessary to make the
statements made, in light of the circumstances under which such statements were
made, not misleading with respect to the period covered by this quarterly report;

15 3. Based on my knowledge, the financial statements, and other financial
16 information included in this quarterly report, fairly present in all material respects
17 the financial condition, results of operations and cash flows of the registrant as of,
and for, the periods presented in this quarterly report[.]

18 (c) Certifications by Schroeder and Kispert pursuant to 18 U.S.C. Section
19 1350 substantially identical to the one in the 2002 Form 10-K.

20 108. On January 23, 2003, the Company issued a press release entitled "KLA-Tencor
21 Posts Second Quarter Earnings of \$29 million on Revenues of \$335 Million." The press
22 release, which quotes Schroeder, states in part:

23 KLA-Tencor Corp. (Nasdaq: KLAC) today announced its operating results for its
24 second quarter of fiscal 2003, ended December 31, 2002. The company posted
25 net income of \$29 million and earnings per share of \$0.15 on revenues of \$335
26 million, as compared to \$49 million on revenues of \$404 million for the same
27 period of the prior fiscal year. Revenue declined by 11 percent, as compared with
the first quarter of fiscal 2003. Income was lower by 43 percent, as a result of the
change in revenue, gains in the first quarter and restructuring-related expenses in
the second quarter. For the three-month period the company continued to realize
significant net income and strong cash flow.

1 109. On February 13, 2003, the Company filed its quarterly report on Form 10-Q for
2 the period ended December 31, 2002 with the SEC ("Q2FY03 Form 10-Q"), which was signed
3 by Schroeder and Kispert. The Company's Q2FY03 Form 10-Q contained the following false
4 and misleading statements

5 (a) For the three-month period ended December 31, 2002, the Company
6 reported net income of \$29,228,000 (\$0.15 per diluted share) and expenses of \$308,162,000.
7 For the six-month period ended December 31, 2002, the Company reported net income of
8 \$80,493,000 (\$0.42 per diluted share) and expenses of \$626,398,000.

9 (b) **"Accounting for Stock-Based Compensation Plans** KLA-Tencor
10 accounts for its employee stock option and employee stock purchase plans under the recognition
11 and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to
12 Employees, and related Interpretations. No stock-based employee compensation is reflected in
13 net income, as all options granted under those plans had an exercise price equal to the market
14 value of the underlying common stock on the date of grant."

15 (c) SOX certifications by Schroeder and Kispert substantially identical to
16 those in the Q1FY03 Form 10-Q.

17 (d) Certifications by Schroeder and Kispert pursuant to 18 U.S.C. Section
18 1350 substantially identical to those in the 2002 Form 10-K.

19 110. On April 23, 2003, the Company issued a press release entitled "KLA-Tencor
20 Posts \$27 Million in Net Income for Third Quarter Fiscal 2003." The press release, which
21 quotes Schroeder, states in part:

22 KLA-Tencor Corp. (Nasdaq: KLAC) today announced operating results for its
23 third quarter of fiscal 2003, ended March 31, 2003. For the three-month period,
24 the company posted net income of \$27 million or \$0.14 per share on revenue of
25 \$304 million versus \$34 million or \$0.17 per share on revenues of \$357 million
for the same period last year. When compared to the prior quarter, revenue
decreased from \$335 million while net income decreased 6% from \$29 million.

26 For the nine-month period, the company posted net income of \$108 million or
27 \$0.56 per share on revenues of \$1.01 billion compared to earnings of \$170 million
or \$0.86 per share and \$1.26 billion in revenue in the first nine months of the
28 previous fiscal year.

1 111. On May 14, 2003, the Company filed its quarterly report on Form 10-Q for the
2 period ended March 31, 2003 with the SEC ("Q3FY03 Form 10-Q"), which was signed by
3 Schroeder and Kispert. The Company's Q3FY03 Form 10-Q contained the following false and
4 misleading statements:

5 (a) For the three-month period ended March 31, 2003, the Company reported
6 net income of \$27,339,000 (\$0.14 per diluted share) and expenses of \$278,698,000. For the
7 nine-month period ended March 31, 2003, the Company reported net income of \$107,832,000
8 (\$0.56 per diluted share) and expenses of \$905,096,000.

9 (b) **"Accounting for Stock-Based Compensation Plans** KLA-Tencor
10 accounts for its employee stock option and employee stock purchase plans under the recognition
11 and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to
12 Employees, and related Interpretations. No stock-based employee compensation is reflected in
13 net income, as all options granted under those plans had an exercise price equal to the market
14 value of the underlying common stock on the date of grant. In December 2002, FASB issued
15 Statement of Financial Accounting Standards No. 148 (SFAS 148), 'Accounting for Stock-
16 Based Compensation Transition and Disclosure'. This Statement amends SFAS 123, to provide
17 alternative methods of transition for an entity that voluntarily changes to the fair value based
18 method of accounting for stock-based employee compensation. It also amends the disclosure
19 provisions of that Statement to require prominent disclosure about the effects on reported net
20 income of an entity's accounting policy decisions with respect to stock-based employee
21 compensation. Finally, this Statement amends APB Opinion No. 28, 'Interim Financial
22 Reporting,' to require disclosure about those effects in interim financial information. Since
23 KLA-Tencor continues to account for stock-based compensation according to APB 25, its
24 adoption of SFAS No. 148 required the Company to provide prominent disclosures about the
25 effects of SFAS 123 on reported income and required the Company to disclose these affects in
26 the interim financial statements as well." The Q3FY03 reported *pro forma* results regarding the
27 effect of stock-based employee compensation as follows:
28

1 (i) For the three months ended March 31, 2002, the Company
2 reported total stock-based employee compensation expense, net of related tax effects, of
3 \$24,813,000 and reported *pro forma* net income of \$9,336,000 (\$0.05 per diluted share).

4 (ii) For the three months ended March 31, 2003, the Company
5 reported total stock-based employee compensation expense, net of related tax effects, of
6 \$20,411,000 and reported *pro forma* net income of \$6,928,000 (\$0.04 per diluted share).

7 (iii) For the nine months ended March 31, 2003 [sic], the Company
8 reported total stock-based employee compensation expense, net of related tax effects, of
9 \$76,171,000 and reported *pro forma* net income of \$93,491,000 (\$0.48 per diluted share).

10 (iv) For the nine months ended March 31, 2003, the Company
11 reported total stock-based employee compensation expense, net of related tax effects, of
12 \$68,018,000 and reported *pro forma* net income of \$39,814,000 (\$0.21 per diluted share).

13 (c) SOX certifications by Schroeder and Kispert substantially identical to
14 those in the Q1FY03 Form 10-Q.

15 (d) Certifications by Schroeder and Kispert, pursuant to 18 U.S.C. Section
16 1350, substantially identical to those in the 2002 Form 10-K.

17 112. On July 24, 2003, the Company issued a press release entitled "KLA-Tencor
18 Reports \$137 Million In Net Income on Revenue Of \$1.32 Billion For Fiscal Year 2003." The
19 press release, which quotes Schroeder, states in part:

20 KLA-Tencor Corporation (NASDAQ: KLAC) today announced operating results
21 for its fourth quarter and 2003 fiscal year. For the quarter ending June 30, 2003,
22 the company reported improvement on a quarter-over-quarter basis. Net income
23 of \$29 million and earnings per share of \$0.15 in the June 2003 fiscal quarter
24 were a 7 percent improvement over net income of \$27 million and earnings per
25 share of \$0.14 posted in the March quarter. Revenue of \$308 million in the June
26 quarter was up slightly from revenue of \$304 million in the March quarter. The
June 2003 quarter results compare to net income of \$47 million and earnings per
share of \$0.23 on revenues of \$373 million for the same period last year. For the
full 2003 fiscal year, KLA-Tencor reported net income of \$137 million and
earnings per share of \$0.70 on revenue of \$1.32 billion compared, to fiscal year
2002 net income of \$216 million and earnings per share of \$1.10 on revenues of
\$1.64 billion.

27 * * *

28 Gross margins improved from 48.5 percent in the third quarter of fiscal year 2003
to 49.0 percent in the fourth quarter. Cost reductions in service and

1 manufacturing expenses contributed to the improvement in gross margins.
2 Operating expenses were unchanged at \$122 million, a decrease in selling,
3 general and administrative expense offset a \$3 million increase in engineering
4 expense.

5 113. On September 16, 2003, the Company filed its annual report on Form 10-K for
6 the period ended June 30, 2003 with the SEC. On September 29, 2003, the Company filed an
7 amended Form 10-K. The original Form 10-K and the amended Form 10-K are collectively
8 referred to hereinafter as the "2003 Form 10-K." The 2003 Form 10-K was signed by Levy,
9 Schroeder, Kispert, Barnholt, Bingham, Bond, Elkus, Kaufman, Tompkins and Urbanek. The
10 Company's 2003 Form 10-K contained the following statements, which were false and
11 misleading:

12 (a) For 2003, the Company reported net income of \$137,191,000 (\$0.70 per
13 diluted share) and expenses of \$1,184,327,000.

14 (b) For the three-month period ended June 30, 2003, KLA reported net
15 income of \$29,359,000 (\$0.15 per diluted share).

16 (c) **"Accounting for Stock-Based Compensation Plans** KLA-Tencor
17 accounts for its employee stock option and employee stock purchase plans under the recognition
18 and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to
19 Employees, and related Interpretations. No stock-based employee compensation is reflected in
20 net income, as all options granted under those plans had an exercise price equal to the market
21 value of the underlying common stock on the date of grant. In December 2002, FASB issued
22 Statement of Financial Accounting Standards No. 148 (SFAS 148), 'Accounting for Stock-
23 Based Compensation Transition and Disclosure.' This Statement amends SFAS 123, to provide
24 alternative methods of transition for an entity that voluntarily changes to the fair value based
25 method of accounting for stock-based employee compensation. It also amends the disclosure
26 provisions of that Statement to require prominent disclosure about the effects on reported net
27 income of an entity's accounting policy decisions with respect to stock-based employee
28 compensation. Finally, this Statement amends APB Opinion No. 28, Interim Financial
Reporting, to require disclosure about those effects in interim financial information. Since

1 KLA-Tencor continues to account for stock-based compensation according to APB Opinion No.
2 25, its adoption of SFAS No. 148 required the Company to provide prominent disclosures about
3 the effects of SFAS 123 on reported income and required the Company to disclose these affects
4 in the financial statements as well.” The 2003 Form 10-K reported total stock-based employee
5 compensation expense (net of related tax effects) of \$90,880,000 and reported *pro forma* net
6 income of \$46,311,000 (\$0.24 per diluted share).

7 (d) SOX certifications by Schroeder and Kispert substantially identical to
8 those in the Q1FY03 Form 10-Q.

9 (e) Certifications by Schroeder and Kispert, pursuant to 18 U.S.C. Section
10 1350, substantially identical to those in the 2002 Form 10-K.

11 114. On October 22, 2003, the Company issued a press release entitled “KLA-Tencor
12 Posts \$37 Million In Net Income On Revenue of \$318 Million for First Quarter of Fiscal Year
13 2004.” The press release, which quotes Schroeder, states in part:

14 KLA-Tencor Corporation (NASDAQ: KLAC) today announced operating results
15 for its first quarter of fiscal 2004, ended September 30, 2003. The company
16 recorded net income of \$37 million and earnings per share of \$0.18 on revenue of
17 \$318 million in the September quarter, each of which reflect a sequential quarter-
18 to-quarter improvement over net income of \$29 million, earnings per share of
\$0.15 and revenue of \$308 million in the June quarter. For the first quarter of last
fiscal year, the company earned net income of \$51 million and earnings per share
of \$0.26 on revenues of \$376 million.

* * *

19 Gross margins improved from 49.0 percent in the June quarter to 51.1 percent in
20 the September quarter. Improvements in manufacturing and service costs
21 contributed to the increase in gross margins. Operating expenses increased
slightly to \$125 million.

22 115. On November 7, 2003, the Company filed its quarterly report on Form 10-Q for
23 the period ended September 30, 2003 with the SEC (“Q1FY04 Form 10-Q”), which was signed
24 by Schroeder and Kispert. This Q1FY04 Form 10-Q contained the following false and
25 misleading statements:

26 (a) For the three-month period ended September 30, 2003, the Company
27 reported net income of \$36,837,000 (\$0.18 per diluted share) and expenses of \$281,002,000.

1 (b) "Accounting for Stock-Based Compensation Plans KLA-Tencor
2 accounAts for its employee stock option and employee stock purchase plans under the
3 recognition and measurement principles of Accounting Principles Board Opinion No. 25,
4 Accounting for Stock Issued to Employees, and related Interpretations. No stock-based
5 employee compensation is reflected in net income, as all options granted under those plans had
6 an exercise price equal to the market value of the underlying common stock on the date of
7 grant. In December 2002, FASB issued Statement of Financial Accounting Standards No. 148
8 (SFAS 148), "Accounting for Stock-Based Compensation Transition and Disclosure." This
9 Statement amends SFAS 123, to provide alternative methods of transition for an entity that
10 voluntarily changes to the fair value based method of accounting for stock-based employee
11 compensation. It also amends the disclosure provisions of that Statement to require prominent
12 disclosure about the effects on reported net income of an entity's accounting policy decisions
13 with respect to stock-based employee compensation. Finally, this Statement amends APB
14 Opinion No. 28, Interim Financial Reporting, to require disclosure about those effects in interim
15 financial information. Since KLA-Tencor continues to account for stock-based compensation
16 according to APB 25, its adoption of SFAS 148 required the Company to provide prominent
17 disclosures about the effects of SFAS 123 on reported income and required the Company to
18 disclose these affects in the financial statements as well." The Q1FY04 reported *pro forma*
19 results regarding the effect of stock-based employee compensation as follows:

20 (i) For the three months ended September 30, 2002, the Company
21 reported total stock-based employee compensation expense, net of related tax effects, of
22 \$24,976,000 and reported *pro forma* net income of \$26,289,000 (\$0.14 per diluted share).

23 (ii) For the three months ended September 30, 2003, the Company
24 reported total stock-based employee compensation expense, net of related tax effects, of
25 \$22,567,000 and reported *pro forma* net income of \$14,270,000 (\$0.07 per diluted share).

26 (c) SOX certifications by Schroeder and Kispert substantially identical to
27 those in the Q1FY03 Form 10-Q.
28

1 (d) Certifications by Schroeder and Kispert, pursuant to 18 U.S.C. Section
2 1350, substantially identical to those in the 2002 Form 10-K.

3 116. On January 22, 2004, the Company issued a press release entitled "KLA-Tencor
4 Posts Earnings Of \$45 Million on Revenues Of \$339 Million For Second Quarter of Fiscal
5 2004." The press release, which quotes Schroeder, states in part:

6 KLA-Tencor Corporation (NASDAQ: KLAC) today announced operating results
7 for its second quarter of fiscal 2004, ended December 31, 2003. The company
8 reported net income of \$45 million and diluted earnings per share of \$0.22 on
9 revenues of \$339 million – an increase on both a year-over-year and sequential
10 basis. In comparison, the second quarter of fiscal 2003 resulted in net income of
\$29 million and diluted earnings per share of \$0.15 on revenues of \$335 million,
while in its first fiscal quarter of fiscal 2004 KLA-Tencor realized net income of
\$37 million and diluted earnings per share of \$0.18 on revenues of \$318 million.

11 * * *

12 Gross margins improved three percent sequentially to 54 percent, which helped
13 drive net income higher by 21 percent over the previous quarter. Improvements in
capacity absorption and manufacturing efficiencies contributed to the gain in
gross margins.

14 117. On February 6, 2004, the Company filed its quarterly report on Form 10-Q for
15 the period ended December 31, 2003 with the SEC ("Q2FY04 Form 10-Q"), which was signed
16 by Schroeder and Kispert. This Q2FY04 Form 10-Q contained the following false and
17 misleading statements:

18 (a) For the three-month period ended December 31, 2003, the Company
19 reported net income of \$44,515,000 (\$0.22 per diluted share) and expenses of \$287,476,000.
20 For the six-month period ended December 31, 2003, the Company reported net income of
21 \$81,352,000 (\$0.40 per diluted share) and expenses of \$568,478,000.

22 (b) The identical representation regarding the application of APB No. 25 and
23 the fact that there is no stock-based employee compensation reflected in net income, "as all
24 options granted under those plans had an exercise price equal to the market value of the
25 underlying common stock on the date of grant," as contained in the Q1FY03 Form 10-Q. The
26 Q2FY04 reported *pro forma* results regarding the effect of stock-based employee compensation
27 as follows:
28

1 (i) For the three months ended December 31, 2002, the Company
2 reported total stock-based employee compensation expense, net of related tax effects, of
3 \$24,976,000 and reported *pro forma* net income of \$5,829,000 (\$0.03 per diluted share).

4 (ii) For the three months ended December 31, 2003, the Company
5 reported total stock-based employee compensation expense, net of related tax effects, of
6 \$24,284,000 and reported *pro forma* net income of \$20,231,000 (\$0.10 per diluted share).

7 (iii) For the six months ended December 31, 2002, the Company
8 reported total stock-based employee compensation expense, net of related tax effects, of
9 \$48,375,000 and reported *pro forma* net income of \$32,118,000 (\$0.17 per diluted share).

10 (iv) For the six months ended December 31, 2003, the Company
11 reported total stock-based employee compensation expense, net of related tax effects, of
12 \$46,851,000 and reported *pro forma* net income of \$34,501,000 (\$0.17 per diluted share).

13 (c) SOX certifications by Schroeder and Kispert substantially identical to
14 those in the Q1FY03 Form 10-Q.

15 (d) Certifications by Schroeder and Kispert, pursuant to 18 U.S.C. Section
16 1350, substantially identical to those in the 2002 Form 10-K.

17 118. On March 5, 2004, KLA filed a Form S-8 Registration Statement, which
18 registered securities to be issued under the Company's Employee Benefit Plan. In this
19 Registration Statement, KLA incorporated by reference the following documents, which
20 contained false and misleading statements: (a) 2003 Form 10-K; (b) Q1FY04 and Q2FY04
21 Forms 10-Q; and (c) 2003 Proxy Statement. This Registration Statement also stated that all
22 documents subsequently filed by the Registrant pursuant to Sections 13(a), 13(c), 14 and 15(d)
23 of the Exchange Act, prior to the filing of a post-effective amendment to this Registration
24 Statement, shall be deemed to be incorporated by reference in this Registration Statement from
25 the date of filing of such documents.

26 119. On April 21, 2004, the Company issued a press release entitled "KLA-Tencor
27 Posts Third Quarter Fiscal Year 2004 Earnings Of \$66 Million On Revenues Of \$390 Million."
28

1 The press release, which quotes Schroeder, states in part:

2 KLA-Tencor Corporation (NASDAQ: KLAC) today announced operating results
3 for its third quarter of fiscal 2004, ended March 31, 2004. Revenues for the
4 quarter were \$390 million, up 15% from \$339 million in the previous quarter, and
5 up 28% from \$304 million in the third quarter of fiscal 2003. The net income for
the quarter was \$66 million or \$0.33 per diluted share, compared with net income
of \$45 million or \$0.22 per diluted share in the prior quarter, and \$27 million or
\$0.14 per diluted share in the third quarter of fiscal 2003.

6 * * *

7 Gross margins improved two percent sequentially to 56 percent in the March
8 quarter from 54 percent in the December quarter, primarily driven by cost
reduction initiatives along with improvements in capacity absorption.

9 120. On May 5, 2004, the Company filed its quarterly report on Form 10-Q for the
10 period ended March 31, 2004 with the SEC ("Q3FY04 Form 10-Q"), which was signed by
11 Schroeder and Kispert. This Q3FY04 Form 10-Q contained the following false and misleading
12 statements:

13 (a) For the three-month period ended March 31, 2004, the Company reported
14 net income of \$66,182,000 (\$0.33 per diluted share) and expenses of \$302,019,000. For the
15 nine-month period ended March 31, 2004, the Company reported net income of \$147,534,000
16 (\$0.73 per diluted share) and expenses of \$870,497,000.

17 (b) The identical representation as contained in the Q1FY04 Form 10-Q
18 regarding the application of APB No. 25 and the fact that there is no stock-based employee
19 compensation reflected in net income "as all options granted under those plans had an exercise
20 price equal to the market value of the underlying common stock on the date of grant." The
21 Q1FY04 reported *pro forma* results regarding the effect of stock-based employee compensation
22 as follows:

23 (i) For the three months ended March 31, 2003, the Company
24 reported total stock-based employee compensation expense, net of related tax effects, of
25 \$20,740,000 and reported *pro forma* net income of \$6,599,000 (\$0.03 per diluted share).

26 (ii) For the three months ended March 31, 2004, the Company
27 reported total stock-based employee compensation expense, net of related tax effects, of
28

1 \$21,718,000 and reported *pro forma* net income of \$44,464,000 (\$0.22 per diluted share).

2 (iii) For the nine months ended March 31, 2003, the Company
3 reported total stock-based employee compensation expense, net of related tax effects, of
4 \$69,115,000 and reported *pro forma* net income of \$38,717,000 (\$0.20 per diluted share).

5 (iv) For the nine months ended March 31, 2004, the Company
6 reported total stock-based employee compensation expense, net of related tax effects, of
7 \$68,569,000 and reported *pro forma* net income of \$78,965,000 (\$0.39 per diluted share).

8 (c) SOX certifications by Schroeder and Kispert substantially identical to
9 those in the Q1FY03 Form 10-Q.

10 (d) Certifications by Schroeder and Kispert, pursuant to 18 U.S.C. Section
11 1350, substantially identical to those in the 2002 Form 10-K.

12 121. On July 29, 2004, the Company issued a press release entitled "KLA-Tencor
13 Reports Earnings of \$244 Million on Revenues of \$1.5 Billion for Fiscal Year 2004." The press
14 release, which quotes Schroeder, states in part:

15 KLA-Tencor Corporation (NASDAQ: KLAC) today announced operating results
16 for its fourth quarter and 2004 fiscal year ended June 30, 2004. The company
17 reported strong gains for both the quarter and full fiscal year. For the quarter, the
18 company reported net income of \$96 million and earnings per diluted share of
19 \$0.48 on revenues of \$450 million, which represented an increase on both a
20 sequential and year-over-year basis. Revenues rose 16 percent from \$390 million
21 in the prior quarter and 46 percent from \$308 million compared to the same
period last year. Net income was also significantly higher, increasing from \$66
million or \$0.33 per diluted share in the prior quarter and \$29 million or \$0.15 per
diluted share in the fourth quarter of fiscal 2003. For the full 2004 fiscal year,
KLA-Tencor reported net income of \$244 million or \$1.21 per diluted share on
revenues of \$1.5 billion versus net income of \$137 million or \$0.70 per diluted
share on revenues of \$1.3 billion in its 2003 fiscal year.

22 * * *

23 Gross margins improved during the quarter, rising another two percent
24 sequentially to 58 percent compared to 56 percent in the third quarter. This
25 improvement was primarily driven by cost reduction initiatives. Cash, cash
26 equivalents and marketable securities increased by \$156 million to \$1.88 billion.
Accounts receivable increased \$10 million to \$373 million on higher product
shipments. Inventory increased by \$27 million to \$337 million, as the company
continued to ramp production to meet customer demand.

27 122. On August 30, 2004, the Company filed its 2004 Form 10-K, which was signed
28

1 by Levy, Schroeder, Kispert, Barnholt, Bingham, Bond, Elkus, Kaufman, Marks, Tompkins and
2 Urbanek. The 2004 Form 10-K contained the following statements, which were false and
3 misleading:

4 (a) The Company reported net income of \$243,701,000 (\$1.21 per diluted
5 share) and expenses of \$1,199,360,000.

6 (b) For the three-month period ended June 30, 2004, KLA reported net
7 income of \$96,167,000 (\$0.48 per diluted share).

8 (c) The identical representations as contained in the 2003 Form 10-K
9 regarding the application of APB No. 25 and the fact that there is no stock-based employee
10 compensation reflected in net income "as all options granted under those plans had an exercise
11 price equal to the market value of the underlying common stock on the date of grant." The
12 Company reported a total stock-based employee compensation expense (net of related tax
13 effects) of \$82,446,000 and reported *pro forma* net income of \$161,225,000 (\$0.80 per diluted
14 share).

15 (d) SOX certifications by Schroeder and Kispert substantially identical to
16 those in the Q1FY03 Form 10-Q.

17 (e) Certifications by Schroeder and Kispert, pursuant to 18 U.S.C. Section
18 1350, substantially identical to those in the 2002 Form 10-K.

19 123. On October 21, 2004, the Company issued a press release entitled "KLA-Tencor
20 Reports Earnings of \$116 Million on Revenues of \$519 Million for First Quarter of Fiscal Year
21 2005." The press release, which quotes Schroeder, states in part:

22 KLA-Tencor Corporation (Nasdaq:KLAC) today announced operating results for
23 its first quarter of fiscal 2005, ended September 30, 2004. Net income and
24 earnings per diluted share rose to \$116 million and \$0.58 on revenues of \$519
25 million, as the company reported sequential and year-over-year improvements in
26 operating results. Revenues rose 15 percent from \$450 million in the prior
quarter and 63 percent from \$318 million compared to the same period last year.
Net income was also significantly higher, increasing from \$96 million or \$0.48
per diluted share in the prior quarter and \$37 million or \$0.18 per diluted share in
the first quarter of fiscal 2004.

27 * * *

28 Rising revenues and improved cost-structure resulted in record level gross
margin, pretax, and operating margin percentages in the current quarter.

1 Operating expenses increased from \$141 million in the prior quarter to \$146
million in the current quarter.

2 124. On November 3, 2004, the Company filed its quarterly report on Form 10-Q for
3 the period ended September 30, 2004 with the SEC ("Q1FY05 Form 10-Q"), which was signed
4 by Schroeder and Kispert. This Q1FY05 Form 10-Q contained the following false and
5 misleading statements:

6 (a) For the three-month period ended September 30, 2004, the Company
7 reported net income of \$116,405,000 (\$0.58 for diluted share) and expenses of \$361,806,000.

8 (b) **"Accounting for Stock-Based Compensation Plans** KLA-Tencor
9 accounts for its employee stock option and employee stock purchase plans under the intrinsic
10 value recognition and measurement principles of Accounting Principles Board Opinion ('APB')
11 No. 25, 'Accounting for Stock Issued to Employees,' and related Interpretations, and has
12 adopted the disclosure-only provisions of Statement of Financial Accounting Standard ('SFAS')
13 No. 123, 'Accounting for Stock-Based Compensation,' as amended by SFAS No. 148,
14 'Accounting for Stock-Based Compensation – Transition and Disclosures.' No stock-based
15 employee compensation is reflected in net income, as all options granted under those plans had
16 an exercise price equal to the market value of the underlying common stock on the date of
17 grant." The Q1FY05 reported *pro forma* results regarding the effect of stock-based employee
18 compensation as follows:

19 (i) For the three months ended September 30, 2003, the Company
20 reported total stock-based employee compensation expense, net of related tax effects, of
21 \$22,567,000 and reported *pro forma* net income of \$14,270,000 (\$0.07 per diluted share).

22 (ii) For the three months ended September 30, 2004, the Company
23 reported total stock-based employee compensation expense, net of related tax effects, of
24 \$20,453,000 and reported *pro forma* net income of \$95,952,000 (\$0.48 per diluted share).

25 (c) SOX certifications by Schroeder and Kispert substantially identical to
26 those in the Q1FY03 Form 10-Q.

27 (d) Certifications by Schroeder and Kispert, pursuant to 18 U.S.C. Section
28

1 1350, substantially identical to those in the 2002 Form 10-K.

2 125. On November 4, 2004, KLA filed a Form S-8 Registration Statement, which
3 registered securities to be issued under the Company's Employee Benefit Plan. In this
4 Registration Statement, KLA incorporated by reference the following documents, which
5 contained false and misleading statements: (a) 2004 Form 10-K; (b) Q2FY05 Form 10-Q; and
6 (c) 2004 Proxy Statement. This Registration Statement also stated that all documents
7 subsequently filed by the Registrant pursuant to Sections 13(a), 13(c), 14 and 15(d) of the
8 Exchange Act, prior to the filing of a post-effective amendment to this Registration Statement,
9 shall be deemed to be incorporated by reference in this Registration Statement from the date of
10 filing of such documents.

11 126. On December 23, 2004, KLA filed a Form S-8 Registration Statement, which
12 registered securities to be issued under the Company's Employee Benefit Plan. In this
13 Registration Statement, KLA incorporated by reference the following documents, which
14 contained false and misleading statements: (a) 2004 Form 10-K; (b) Q1FY05 Form 10-Q; and
15 (c) 2004 Proxy Statement. This Registration Statement also stated that all documents
16 subsequently filed by the Registrant pursuant to Sections 13(a), 13(c), 14 and 15(d) of the
17 Exchange Act, prior to the filing of a post-effective amendment to this Registration Statement,
18 shall be deemed to be incorporated by reference in this Registration Statement from the date of
19 filing of such documents.

20 127. On January 20, 2005, the Company issued a press release entitled "KLA-Tencor
21 Posts Second Quarter Fiscal Year 2005 Earnings of \$122 Million on Revenues of \$533
22 Million." The press release, which quotes Schroeder, states in part:

23 KLA-Tencor Corporation (NASDAQ: KLAC) today announced operating results
24 for its second quarter of fiscal 2005, ended December 31, 2004. Revenues for the
25 quarter were \$533 million, up 3% from \$519 million in the previous quarter, and
26 up 57% from \$339 million in the second quarter of fiscal 2004. The net income
for the quarter was \$122 million or \$0.61 per diluted share, compared with net
income of \$116 million or \$0.58 per diluted share in the prior quarter, and \$45
million or \$0.22 per diluted share in the second quarter of fiscal 2004.

27 128. On February 3, 2005, the Company filed its quarterly report on Form 10-Q for
28

1 the period ended December 31, 2004 with the SEC ("Q2FY05 Form 10-Q"), which was signed
2 by Schroeder and Kispert. This Form 10-Q contained the following false and misleading
3 statements:

4 (a) For the three-month period ended December 31, 2004, the Company
5 reported net income of \$122,077,000 (\$0.61 per diluted share) and expenses of \$377,345,000.
6 For the six-month period ended December 31, 2004, the Company reported net income of
7 \$238,482,000 (\$1.19 per diluted share) and expenses of \$739,151,000.

8 (b) **"Accounting for Stock-Based Compensation Plans** KLA-Tencor
9 accounts for its employee stock option and employee stock purchase plans under the intrinsic
10 value recognition and measurement principles of Accounting Principles Board Opinion ('APB')
11 No. 25, 'Accounting for Stock Issued to Employees,' and related Interpretations, and has
12 adopted the disclosure-only provisions of Statement of Financial Accounting Standard ('SFAS')
13 No. 123, 'Accounting for Stock-Based Compensation,' as amended by SFAS No. 148,
14 'Accounting for Stock-Based Compensation - Transition and Disclosures.'" The Q2FY05
15 reported *pro forma* results regarding the effect of stock-based employee compensation as
16 follows:

17 (i) For the three months ended December 31, 2003, the Company
18 reported total stock-based compensation expense, net of related tax effects, of \$24,284,000 and
19 reported *pro forma* net income of \$20,231,000 (\$0.10 per diluted share).

20 (ii) For the three months ended December 31, 2004, the Company
21 reported total stock-based compensation expense, net of related tax effects, of \$21,077,000 and
22 reported *pro forma* net income of \$101,000,000 (\$0.50 per diluted share).

23 (iii) For the six months ended December 31, 2003, the Company
24 reported total stock-based compensation expense, net of related tax effects, of \$46,851,000 and
25 reported *pro forma* net income of \$34,501,000 (\$0.17 per diluted share).

26 (iv) For the six months ended December 31, 2004, the Company
27 reported total stock-based compensation expense, net of related tax effects, of \$41,530,000 and
28

1 reported *pro forma* net income of \$196,952,000 (\$0.98 per diluted share).

2 (c) SOX certifications by Schroeder and Kispert substantially identical to
3 those in the Q1FY03 Form 10-Q.

4 (d) Certifications by Schroeder and Kispert, pursuant to 18 U.S.C. Section
5 1350, substantially identical to those in the 2002 Form 10-K.

6 129. On April 28, 2005, the Company issued a press release entitled "KLA-Tencor
7 Posts Third Quarter Fiscal Year 2005 Earnings of \$123 Million on Revenues of \$542 Million."
8 The press release, which quotes Schroeder, states in part:

9 KLA-Tencor Corporation (NASDAQ: KLAC) today announced operating results
10 for its third quarter of fiscal 2005, ended March 31, 2005. Revenues for the
11 quarter were \$542 million, up 2% from \$533 million in the previous quarter and
12 up 39% from \$390 million in the third quarter of fiscal 2004. The net income for
the quarter was \$123 million or \$0.61 per diluted share, compared with net
income of \$122 million or \$0.61 per diluted share in the prior quarter and \$66
million or \$0.33 per diluted share in the third quarter of fiscal 2004.

13 * * *

14 We continued to have strong gross margins as we benefit from cost reductions
15 initiatives and high manufacturing utilization. Operating expenses increased from
16 \$160 million in the prior quarter to \$165 million in the current quarter as a result
of investment in research and development for new process control technology
solutions and systems to drive business efficiencies.

17 130. On May 9, 2005, the Company filed its quarterly report on Form 10-Q for the
18 period ended March 31, 2005 with the SEC ("Q3FY05 Form 10-Q"), which was signed by
19 Schroeder and Kispert. This Q3FY05 Form 10-Q contained the following false and misleading
20 statements:

21 (a) For the three-month period ended March 31, 2005, the Company reported
22 net income of \$123,163,000 (\$0.61 per diluted share) and expenses of \$386,764,000. For the
23 nine-month period ended March 31, 2005, the Company reported net income of \$361,645,000
24 (\$1.80 per diluted share) and expenses of \$1,125,915,000.

25 (b) The identical representations regarding the application of APB No. 25 as
26 contained in the Q2FY05 Form 10-Q. The Q3FY05 reported *pro forma* results regarding the
27 effect of stock-based employee compensation as follows:

1 (i) For the three months ended March 31, 2004, the Company
2 reported total stock-based compensation expense, net of related tax effects, of \$21,718,000 and
3 reported *pro forma* net income of \$44,464,000 (\$0.22 per diluted share).

4 (ii) For the three months ended March 31, 2005, the Company
5 reported total stock-based compensation expense, net of related tax effects, of \$24,575,000 and
6 reported *pro forma* net income of \$98,588,000 (\$0.49 per diluted share).

7 (iii) For the nine months ended March 31, 2004, the Company
8 reported total stock-based compensation expense, net of related tax effects, of \$68,569,000 and
9 reported *pro forma* net income of \$78,965,000 (\$0.39 per diluted share).

10 (iv) For the nine months ended March 31, 2005, the Company
11 reported total stock-based compensation expense, net of related tax effects, of \$66,105,000 and
12 reported *pro forma* net income of \$295,540,000 (\$1.47 per diluted share).

13 (c) SOX certifications by Schroeder and Kispert substantially identical to
14 those in the Q1FY03 Form 10-Q.

15 (d) Certifications by Schroeder and Kispert, pursuant to 18 U.S.C. Section
16 1350, substantially identical to those in the 2002 Form 10-K.

17 131. On July 28, 2005, the Company issued a press release entitled "KLA-Tencor
18 Reports Earnings of \$467 Million on Revenues of \$2.1 Billion for Fiscal Year 2005." The press
19 release, which quotes Schroeder, states in part:

20 KLA-Tencor Corporation (NASDAQ: KLAC) today announced operating results
21 for its fourth quarter and 2005 fiscal year ended June 30, 2005. The company
22 realized strong gains for the full 2005 fiscal year, and reported net income of \$467
23 million or \$2.32 per diluted share on revenues of \$2.1 billion versus net income of
24 \$244 million or \$1.21 per diluted share on revenues of \$1.5 billion in its 2004
25 fiscal year. For the quarter ended June 30, 2005, the company reported net
income of \$105 million and earnings per diluted share of \$0.52 on revenues of
\$492 million compared to net income of \$96 million or \$0.48 per diluted shares
on revenue of \$450 million in the fourth quarter of fiscal 2004, and net income of
\$123 million or \$0.61 per diluted shares on revenue of \$542 million in the third
quarter of fiscal 2005.

26 132. On September 2, 2005, the Company filed its 2005 Form 10-K, which was
27 signed by Levy, Schroeder, Kispert, Barnholt, Bingham, Bond, Elkus, Kaufman, Marks,
28

1 Tompkins and Urbanek. This 2005 Form 10-K contained the following statements, which were
2 false and misleading:

3 (a) The Company reported net income of \$466,695,000 (\$2.32 per diluted
4 share) and expenses of \$1,502,591,000.

5 (b) For the three-month period ended June 30, 2005, KLA reported net
6 income of \$105,050,000 (\$0.52 per diluted share).

7 (c) The identical representations regarding the application of APB No. 25 as
8 contained in the Q2FY05 Form 10-Q. The 2005 Form 10-K reported (i) total stock-based
9 compensation expenses included in reported net income (net of tax) of \$1,831,000; (ii) total
10 stock-based employee compensation expense determined under the fair value based method (net
11 of related tax effects) of \$93,281,000; and (iii) *pro forma* net income of \$375,245,000 (\$1.87
12 per diluted share).

13 (d) SOX certifications by Schroeder and Kispert substantially identical to
14 those in the Q1FY03 Form 10-Q.

15 (e) Certifications by Schroeder and Kispert, pursuant to 18 U.S.C. Section
16 1350, substantially identical to those in the 2002 Form 10-K.

17 133. On October 27, 2005, KLA issued a press release entitled "KLA-Tencor Reports
18 First Quarter of 2006 Earnings Per Share of \$0.38 (\$0.50 Excluding Equity Based
19 Compensation Of \$0.12) on Revenue of \$484 Million." The press release, which quotes
20 Schroeder, states in part:

21 KLA-Tencor Corporation (NASDAQ: KLAC) today announced operating results
22 for its first quarter of fiscal 2006, ended September 30, 2005. The company
23 reported net income of \$77 million and earnings per diluted share of \$0.38 on
24 revenues of \$484 million compared to net income of \$105 million or \$0.52 per
25 diluted shares on revenue of \$492 million in the fourth quarter of fiscal 2005, and
26 net income of \$116 million or \$0.58 per diluted shares on revenue of \$519 million
27 in the first quarter of fiscal 2005. The results include the impact from adoption in
28 the first quarter of fiscal 2006 of SFAS 123 (R). The company included equity
based compensation expenses of \$24 million or \$0.12 per diluted share, after
income tax expenses, in its costs and operating expenses during the first quarter of
fiscal 2006. Excluding the \$24 million of equity based compensation, net income
would have been \$101 million and earnings per diluted share would have been
\$0.50 for the first quarter of fiscal 2006.

1 134. On November 8, 2005, the Company filed its quarterly report on Form 10-Q for
2 the period ended September 30, 2005 with the SEC ("Q1FY06 Form 10-Q"), which was signed
3 by Schroeder and Kispert. This Q1FY06 Form 10-Q contained the following false and
4 misleading statements:

5 (a) For the three-month period ended September 30, 2005, the Company
6 reported net income of \$76,678,000 (\$0.38 per diluted share) and expenses of \$403,022,000.

7 (b) For the three-month period ended September 30, 2005, the Company
8 reported total stock-based compensation expense pursuant to SFAS No. 123(R), of \$34,828,000
9 and \$24,172,000 or \$0.12 per diluted share, net of related tax effects.

10 (c) "Effective July 1, 2005, KLA-Tencor adopted the provisions of SFAS
11 No. 123(R), 'Share-Based Payment'. SFAS No. 123(R) establishes accounting for stock-based
12 awards exchanged for employee services. Accordingly, stock-based compensation cost is
13 measured at grant date, based on the fair value of the award, and is recognized as expense over
14 the employee requisite service period. The Company previously applied Accounting Principles
15 Board (APB) Opinion No. 25, 'Accounting for Stock Issued to Employees,' and related
16 Interpretations and provided the required pro forma disclosures of SFAS No. 123, 'Accounting
17 for Stock-Based Compensation.'" The Q1FY06 reported, for the three months ended
18 September 30, 2004, total stock-based compensation expense, net of related tax effects, of
19 \$20,453,000 and *pro forma* net income of \$95,952,000 (\$0.48 per diluted share).

20 (d) SOX certifications by Schroeder and Kispert substantially identical to
21 those in the Q1FY03 Form 10-Q.

22 (e) Certifications by Schroeder and Kispert, pursuant to 18 U.S.C. Section
23 1350, substantially identical to those in the 2002 Form 10-K.

24 135. On November 21, 2005, KLA filed a Form S-8 Registration Statement, which
25 registered securities to be issued under the Company's Employee Benefit Plan. In this
26 Registration Statement, KLA incorporated by reference the following documents which
27 contained false and misleading statements: (a) 2005 Form 10-K; (b) Q1FY06 Form 10-Q; and
28

1 (c) 2005 Proxy Statement. This Registration Statement also stated that all documents
2 subsequently filed by the Registrant pursuant to Sections 13(a), 13(c), 14 and 15(d) of the
3 Exchange Act, prior to the filing of a post-effective amendment to this Registration Statement,
4 shall be deemed to be incorporated by reference in this Registration Statement from the date of
5 filing of such documents.

6 136. On January 26, 2006, the Company issued a press release entitled "KLA-Tencor
7 Reports 2nd Quarter of Fiscal 2006 Earnings Per Share of \$0.38 (\$0.50 Excluding Equity Based
8 Compensation) on Revenue of \$488 Million." The press release, which quotes Wallace, states
9 in part:

10 KLA-Tencor Corporation (NASDAQ: KLAC) today announced operating results
11 for its second quarter of fiscal 2006, ended December 31, 2005. The company
12 reported net income of \$77 million and earnings per diluted share of \$0.38 on
13 revenues of \$488 million compared to net income of \$77 million or \$0.38 per
14 diluted share on revenue of \$484 million in the first quarter of fiscal 2006, and net
15 income of \$122 million or \$0.61 per diluted share on revenue of \$533 million in
16 the second quarter of fiscal 2005. The results for the fiscal 2006 quarters include
17 the impact from adoption of SFAS 123 (R) "Stock Based Compensation". The
company recorded after-tax equity-based compensation expenses of \$25 million
during the second quarter of fiscal 2006 and \$24 million during the first quarter of
fiscal 2006, in its costs and operating expenses. Excluding the impact of equity-
based compensation, net income would have been \$102 million or \$0.50 per
diluted share in the second quarter of fiscal 2006 and \$101 million or \$0.50 per
diluted share for the first quarter of fiscal 2006.

18 137. On February 2, 2006, the Company filed its quarterly report on Form 10-Q for
19 the period ended December 31, 2005 with the SEC ("Q2FY06 Form 10-Q"), which was signed
20 by Wallace and Hall. This Q2FY06 Form 10-Q contained the following false and misleading
21 statements:

22 (a) For the three-month period ended December 31, 2005, the Company
23 reported net income of \$76,649,000 (\$0.38 per diluted share) and expenses of \$411,455,000.
24 For the six-month period ended December 31, 2005, the Company reported net income of
25 \$153,327,000 (\$0.76 per diluted share) and expenses of \$814,477,000.

26 (b) For the three-month period ended December 31, 2005, the Company
27 reported total stock-based compensation expense pursuant to SFAS No. 123(R) of \$36,254,000
28

1 (\$25,812,000 or \$0.13 per diluted share net of related tax effects).

2 (c) For the three-month period ended December 31, 2004, the Company
3 reported total stock-based expense of \$21,077,000 and net income of \$101,800,000 (\$0.50 per
4 diluted share).

5 (d) For the six-month period ended December 31, 2005, the Company
6 reported total stock-based compensation expense pursuant to SFAS No. 123(R) of \$71,082,000
7 (\$49,984,000 or \$0.25 per diluted share net of related tax effects).

8 (e) For the six-month period ended December 31, 2004, the Company
9 reported total stock-based compensation expense of \$41,530,000 and net income of
10 \$196,952,000 (\$0.98 per diluted share).

11 (f) The identical statement regarding the adoption of SFAS No. 123(R), as
12 contained in the Q1FY06 Form 10-Q.

13 (g) SOX certifications by Wallace and Hall substantially identical to those in
14 the Q1FY03 Form 10-Q.

15 (h) Certifications by Wallace and Hall, pursuant to 18 U.S.C. Section 1350,
16 substantially identical to those in the 2002 Form 10-K.

17 138. On April 27, 2006, the Company issued a press release entitled "KLA-Tencor
18 Reports Third Quarter of Fiscal 2006 Earnings Per Share of \$0.48 (\$0.63 Excluding Equity
19 Based Compensation) on Revenue of \$518 Million." The press release, which quotes Wallace,
20 states in part:

21 KLA-Tencor Corporation (NASDAQ: KLAC) today announced operating results
22 for its third quarter of fiscal 2006, ended March 31, 2006. The company reported
23 net income of \$98 million and earnings per diluted share of \$0.48 on revenues of
24 \$518 million compared to net income of \$77 million or \$0.38 per diluted share on
25 revenue of \$488 million in the second quarter of fiscal 2006, and net income of
26 \$123 million or \$0.61 per diluted share on revenue of \$542 million in the third
27 quarter of fiscal 2005. The results for the fiscal 2006 quarters include the impact
28 from adoption of SFAS 123 (R) "Stock Based Compensation". The company
recorded after tax equity based compensation expenses of \$31 million during the
third quarter of fiscal 2006 and \$25 million during the second quarter of fiscal
2006, in its costs and operating expenses. Excluding the impact of equity based
compensation, net income would have been \$129 million or \$0.63 per diluted
share for the third quarter of fiscal 2006 and \$102 million or \$0.50 per diluted
share in the second quarter of fiscal 2006.

* * *

140. On May 18, 2006, KLA filed Proxy Statement/Prospectus on Form S-4A with

1 the SEC. This Proxy Statement/Prospectus incorporated by reference the following KLA filings
2 which contained false and misleading statements: (a) 2005 Form 10-K; (b) Q1FY06, Q2FY06
3 and Q3FY06 Forms 10-Q; (c) reports on Form 8-K filed on July 28, 2005 (Item 5.02 and
4 corresponding Exhibit 99.1 press release only) and November 8, 2005. This Registration
5 Statement also stated that all documents subsequently filed by the Registrant pursuant to
6 Sections 13(a), 13(c), 14 and 15(d) of the Exchange Act, prior to the filing of a post-effective
7 amendment to this Registration Statement, shall be deemed to be incorporated by reference in
8 this Registration Statement from the date of filing of such documents.

9 **(b) The Reasons Why The Financial Statements Were False And**
10 **Misleading**

11 141. As alleged more fully below, the statements contained in ¶¶92-140 (including the
12 reported financial figures and representations regarding compliance with GAAP, SEC
13 regulations and SOX) were materially false and misleading. The Company's financial and
14 operating results reported during the Class Period were due, in material part, as the Company
15 has admitted, to falsification of financial results.

16 142. According to SEC regulations, public companies must prepare their financial
17 statements in accordance with GAAP. GAAP are the principles recognized by the accounting
18 profession as the conventions, rules and procedures necessary to define accepted accounting
19 practices at a particular time. GAAP is also a term used to broadly describe the body of
20 principles that governs the accounting for financial transactions underlying the preparation of a
21 set of financial statements. GAAP are derived from a variety of sources, including
22 promulgations of the Financial Accounting Standards Board and its predecessor, the APB, and
23 AICPA. Other sources include the general body of accounting literature consisting of
24 textbooks, articles, papers, etc. GAAP standards are the official standards accepted by the SEC.
25 By failing to comply with GAAP, KLA's financial statements are presumptively in violation of
26
27
28

1 those regulations.²

2 143. The statements contained in ¶¶92-140 violated GAAP with respect to the
3 Company's specific reporting of its compensation expenses, its net income figures and its tax
4 liabilities as well as with respect to the reporting of the Company's financial condition
5 generally. Paragraphs 144-151 summarize how the compensation expenses were understated
6 and how the net income figures were overstated. Paragraphs 152-155 summarize the improper
7 recording of tax liabilities. Paragraphs 156-164 summarize how the Management Discussion
8 and Analysis of Financial Condition and Results of Operations ("MD&A") failed to disclose
9 that KLA was not in compliance with GAAP or the terms of its own option plans.

10 **(i) Improper Accounting For Stock Options**

11 144. Since 1995, the principal accounting guidance for stock options is contained in
12 SFAS 123. However, for interim or annual periods beginning prior to June 15, 2005,
13 companies were permitted to account for stock options under the previous guidance known as
14 the "intrinsic value method" contained in APB No. 25, so long as they included added
15 disclosure requirements.³

16
17 ² SEC Rule 4-01(a) of SEC regulation S-X states that "[f]inancial statements filed with the
18 Commission which are not prepared in accordance with [GAAP] will be presumed to be
19 misleading or inaccurate, despite footnote or other disclosures, unless the Commission has
20 otherwise provided." 17 C.F.R. §210.4-01(a)(1). Regulation S-X requires that interim financial
21 statements must also comply with GAAP. 17 C.F.R. §210.10-01(a). The SEC also regulates
22 statements by registrants "that can reasonably be expected to reach investors and the trading
23 markets, whoever the intended primary audience." Public Statements by Corporate
24 Representatives, SEC Release Nos. 33-6504, 34-20560, 3 Fed. Sec. L. Rep. (CCH) ¶23,120B, at
25 17,096, 1984 SEC LEXIS 2559, at *2 (Jan. 13, 1984).

26 ³ SFAS 123, ¶11, stated in part:

27 This Statement provides a choice of accounting methods for transactions with
28 employees that are within the scope of Opinion 25. Paragraphs 16-44 of this
Statement describe a method of accounting based on the fair value, rather than the
intrinsic value, of an employee stock option or a similar equity instrument. The
Board encourages entities to adopt the fair value based method of accounting,
which is preferable to the Opinion 25 method for purposes of justifying a change
in accounting principle under APB Opinion No. 20, *Accounting Changes*.
However, an entity may continue to apply Opinion 25 in accounting for its stock-
based employee compensation arrangements. An entity that does so shall disclose
pro forma net income and, if presented, earnings per share, determined as if the
fair value based method had been applied in measuring compensation cost
(paragraph 45).

Compensation for services that a corporation receives as consideration for stock issued through employee stock option, purchase, and award plans should be measured by the quoted market price of the stock at the measurement date less the amount, if any, that the employee is required to pay.

* * *

146. Under the intrinsic value method, total compensation cost (stock option expense) is computed as the excess of the market price of the stock over the option price on the date when both the number of shares to which the employees are entitled and the option or purchase price for those shares are known. This date is called the “measurement date.” For many plans, the measurement date is the grant date. In essence, APB No. 25 requires that companies recognize compensation expense for options granted where the market price of the stock exceeds the option’s exercise price on the date of the grant. Total compensation is equal to the total number of options granted multiplied by the difference between the exercise price and market price of the stock on the date of grant. The intrinsic value or total compensation is then recognized as an expense “over the period the employee performs related services” – that is, the intrinsic value is amortized as compensation expense over the option’s vesting period. If the exercise price equals the prevailing market price, then this expense is zero. If the options are priced below a stock’s fair market value when they are awarded, there is an instant paper gain. Under APB No. 25, that paper gain is the equivalent of additional compensation to the executive that must be treated as a cost to the corporation. A company that fails to record or amortize the intrinsic value of the in-the-money options understates compensation expense and overstates net income on its income statement each year during the vesting period of an option.

147. From prior to the start of the Class Period through June 30, 2006, KLA violated APB No. 25 by ascribing little to no value to the total compensation expense. In fact, the

(Emphasis in original, footnote omitted.)

1 Company should have reported hundreds of millions of dollars of added compensation cost
2 caused when option grants were backdated such that the amounts employees were required to
3 pay were less than the price of the options at grant date. The Company has admitted to these
4 violations:

5 (a) In its 2006 Form 10-K, the *Company admitted that certain of its stock*
6 *options had been retroactively priced* such that the option exercise price was not the market
7 price of the option shares on the actual grant date of the option but rather was a lower market
8 price from a different date.

9 (b) It has also admitted that “[t]he actual grant date – when the essential
10 actions necessary to grant the option were completed, including the final determination of the
11 number of shares to be granted to each employee and the exercise price – is the correct
12 measurement date to determine the market price of the option shares under the accounting rules
13 in effect at the time.”

14 (c) Yet, as the *Company admitted, “the retroactively priced options were*
15 *not accounted for correctly in our previously issued financial statements.”* (Emphasis added.)
16 Specifically, the Company explained in its 2006 Form 10-K that:

17 *“[b]ecause each of our retroactively priced options had an exercise price below*
18 *the market price on the actual grant date, there should have been a charge for*
19 *each of these options under APB Opinion No. 25 equal to the number of option*
20 *shares, multiplied by the difference between the exercise price and the market*
price on the actual grant date. That expense should have been amortized over
the vesting period of the option.” (Emphasis added)

21 (d) As detailed in ¶150 below, the Company recorded additional pre-tax,
22 non-cash, stock-based compensation expense of \$348 million for the periods July 1, 1994 to
23 June 30, 2005 under APB No. 25 in order to correct these past accounting misrepresentations.

24 148. In December 2004, SFAS 123 was revised. The new standard, SFAS 123(R),
25 required recognition of the cost of options (as per the fair value method) in the financial statements
26 and eliminated the use of APB No. 25:

27 10. An entity shall account for the compensation cost from share-based payment
28 transactions with employees in accordance with the fair-value-based method set

SFAS 123(R) became effective for interim or annual periods beginning after June 15, 2005.

150. KLA's financial results for Q1FY06, Q2FY06 and Q3FY06 violated SFAS No. 123(R) by failing to record certain stock-based compensation, as evidenced by the Company's own admissions. In its 2006 Form 10-K, *the Company admitted that it "did not record...stock-based compensation expenses under...SFAS No. 123(R) related to our retroactively priced options in our previously issued financial statements."* (Emphasis added.)

(ii) Improper Tax Reporting For Stock Options

[06-cv-04065-MJJ] CONSOLIDATED FEDERAL
SECURITIES CLASS ACTION COMPLAINT

1 §162(m).⁴

2 153. Under IRC Section 162(m), a publicly held corporation's tax deduction for
3 compensation paid to its chief executive officer and to its next four highest compensated
4 officers is limited to \$1 million per year, except for payments that qualify as commissions or as
5 "performance-based" compensation. Option compensation that satisfies certain criteria may be
6 considered "performance-based compensation" and, as such, would be excluded from the \$1
7 million limit. Ordinarily, stock options with an exercise price that is no less than the fair market
8 value of the stock on the date of grant qualify as "performance-based" compensation under
9 §162(m). However, if a stock option has been backdated and, as a result, was granted with an
10 exercise price that was less than the fair market value of the stock on the date of the actual
11 grant, all of the income resulting from the exercise of the option must be included for purposes
12 of calculating whether the executive's compensation exceeded the \$1 million cap under Section
13 162(m).

14 154. According to KLA's proxy statements, the following defendants were among the
15 top five paid executives during the Class Period and, thus, potentially subject to the \$1 million
16 cap under IRC Section 162(m): Levy, Schroeder, Hall, Dickerson, Tompkins, Kispert and
17 Wallace. Because these officers were granted "in-the-money" options as alleged herein, their
18 compensation did not qualify for special treatment under IRC Section 162(m) and the Company
19 should not have been allowed to deduct the compensation to these officers that exceeded \$1
20 million for tax purposes.

21 155. The Company has conceded that, because options were backdated, it improperly
22 recorded additional deferred tax assets related to stock-based compensation on certain executive
23 compensation. In its 2006 Form 10-K, the Company stated that *"it should not have taken a*
24 *United States tax deduction in prior years for stock option related amounts pertaining to*
25 *certain executives under [IRC] Section 162(m)."* (Emphasis added.) *The Company further*

26
27
28 ⁴ As discussed below, the Company also violated their withholding obligations under IRC
Section 421(a).

1 *admitted that "excess deductions were taken on prior tax returns due to the finding that*
2 *retroactive pricing of certain stock options occurred. As a result, the Company's tax*
3 *liabilities have increased by approximately \$8 million."* (Emphasis added.)

4 (iii) **The Misleading Statements In The Management Discussion**
5 **And Analysis Section Of The Financial Statements**

6 156. The discussions also violated GAAP and the SEC regulations in that the MD&A
7 of Financial Condition and Results of Operations failed to disclose that KLA was not in
8 compliance with GAAP or the terms of its own option plans.

9 157. The financial statements' Item 7 of Form 10-K and Item 2 of Form 10-Q,
10 MD&A of Financial Condition and Results of Operations, required the issuer to furnish
11 information required by Item 303 of Regulation S-K (17 C.F.R. §229.303). On May 18, 1989,
12 the SEC issued an interpretive release, Securities Act release No. 6835, 54 Fed. Reg. 22427
13 (May 18, 1989), which stated in part:

14 The MD&A requirements are intended to provide, in one section of a filing,
15 material historical and prospective textual disclosure enabling investors and other
16 users to assess the financial condition and results of operations of the registrant,
with particular emphasis on the registrant's prospects for the future. As the
Concept Release states:

17 The Commission has long recognized the need for a narrative
18 explanation of the financial statements, because a numerical
19 presentation and brief accompanying footnotes alone may be
20 insufficient for an investor to judge the quality of earnings and the
21 likelihood that past performance is indicative of future
22 performance. MD&A is intended to give the investor an
opportunity to look at the company through the eyes of
management by providing both a short and long-term analysis of
the business of the company. The Item asks management to
discuss the dynamics of the business and to analyze the financials.

23 (Footnotes omitted.)

24 158. Securities Act Release No. 6349, 23 S.E.C Docket 962 (Sept. 28, 1981) provides
25 that:

26 It is the responsibility of management to identify and address those key variables
27 and other qualitative and quantitative factors which are peculiar to and necessary
28 for an understanding and evaluation of the individual company.

1 159. Under SEC regulations, the management of a public company has a duty “to
2 make full and prompt announcements of material facts regarding the company’s financial
3 condition.”⁵ Defendants violated this regulation throughout the Class Period by deliberately
4 and/or recklessly misrepresenting the specific terms and annual costs of the Company’s
5 employee and director stock option grants.

6 160. Defendants failed to explain in the MD&A sections of their annual and quarterly
7 SEC filings that they had caused KLA *to not be in compliance with GAAP or the terms of its*
8 *own option plans*. Moreover, defendants violated the basic precepts noted above by (a)
9 concealing from the public a complete understanding of material facts relating to KLA’s
10 compensation expenses, specifically the costs the Company would have incurred if it had
11 properly accounted for stock options that defendants improperly backdated; and (b) concealing
12 from the public a complete understanding of material facts relating to defendants’ practice of
13 opportunistically granting options, specifically that: (i) while the options granted to executives,
14 employees and directors of the Company appeared, based on the usual characteristics of such
15 instruments, to be a form of “risk-based compensation,” they were, instead, a disguised form of
16 straight compensation, as defendants’ practices substantially eliminated the risks faced by these
17 option recipients; and (ii) by means of this subterfuge, defendants’ compensation practices were
18 performed in an improper manner.

19 161. Due to all these accounting improprieties set forth above, KLA presented its
20 financial results and statements in a manner which violated GAAP including the following
21 fundamental accounting principles:

22 (a) The principle that interim financial reporting should be based upon the
23 same accounting principles and practices used to prepare annual financial statements (APB No.
24 28, ¶10).

25 (b) The principle that financial reporting should provide information that is
26

27 ⁵ Timely Disclosure of Material Corporate Developments, Exchange Act Release No. 34-8995,
28 3 Fed. Sec. L. Rep. (CCH) ¶23,120A, at 17,095, 17 C.F.R. §241.8995, 1970 WL 10576 (Oct.
15, 1970).

1 useful to present and potential investors, creditors and other users in making rational
2 investment, credit and similar decisions (FASB Statement of Financial Accounting Concepts
3 No. 1, ¶34).

4 (c) The principle that financial reporting should provide information about
5 the economic resources of an enterprise, the claims to those resources and effects of
6 transactions, events and circumstances that change resources and claims to those resources
7 (FASB Statement of Financial Accounting Concepts No. 1, ¶48).

8 (d) The principle that financial reporting should provide information about
9 how management of an enterprise has discharged its stewardship responsibility to owners
10 (stockholders) for the use of enterprise resources entrusted to it. To the extent that management
11 offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for
12 accountability to prospective investors and to the public in general (FASB Statement of
13 Financial Accounting Concepts No. 1, ¶50).

14 (e) The principle that financial reporting should provide information about
15 an enterprise's financial performance during a period. Investors and creditors often use
16 information about the past to help in assessing the prospects of an enterprise. Thus, although
17 investment and credit decisions reflect investors' expectations about future enterprise
18 performance, those expectations are commonly based at least partly on evaluations of past
19 enterprise performance (FASB Statement of Financial Accounting Concepts No. 1, ¶42).

20 (f) The principle that financial reporting should be reliable in that it
21 represents what it purports to represent. That information should be reliable as well as relevant
22 is a notion that is central to accounting (FASB Statement of Financial Accounting Concepts No.
23 2, ¶¶58-59).

24 (g) The principle of completeness, which means that nothing is left out of the
25 information that may be necessary to insure that it validly represents underlying events and
26 conditions was violated (FASB Statement of Financial Accounting Concepts No. 2, ¶79).

27 (h) The principle that conservatism be used as a prudent reaction to
28

1 uncertainty to try to ensure that uncertainties and risks inherent in business situations are
2 adequately considered. The best way to avoid injury to investors is to try to ensure that what is
3 reported represents what it purports to represent (FASB Statement of Financial Accounting
4 Concepts No. 2, ¶¶95, 97).

5 162. Because of these GAAP violations, the Company restated its financial statements
6 for 1997 through 2005 in its 2006 Form 10-K and Q2FY07 Form 10-Q. Attached as Exhibit A
7 hereto is a chart summarizing the Restatement.

8 163. The Company has further stated that it intends to later restate its previously filed
9 financial statements for the quarter ended March 31, 2006.

10 164. Pursuant to GAAP, as set forth in APB Opinion No. 20,⁶ restatements are
11 required to correct *material* accounting errors that existed at the time the financial statements
12 were issued and are permitted for the purpose of correcting improper accounting only when it
13 results in *material* misstatements. By restating KLA's financial statements, the Company is
14 admitting that each document publishing the original financial statements for the restated
15 periods contained untrue statements and/or omissions of material fact. Similarly, by
16 announcing the restatement, the Company is also conceding that each of the press releases
17 disseminated to the investing public and each of the annual and quarterly reports on Form 10-K
18 and Form 10-Q that were filed with the SEC during the Class Period contained untrue
19 statements of material fact and/or failed to disclose material facts.

20 2. The False and Misleading Statements Regarding the Option Grants

21 (a) The Misleading Statements

22 165. In the section discussing "Stock Option and Incentive Plans," the Company's
23 2001 Form 10-K stated that "[u]nder KLA-Tencor's stock option plans, options generally have
24 vesting periods of four or five years, are exercisable for a period not to exceed ten years from
25

26 _____
27 ⁶ As of December 2005, APB Opinion No. 20 was superseded by SFAS No. 154, "Accounting
28 Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No.
3," which carried forward without change the guidance contained in APB Opinion No. 20 for
reporting the correction of an error in previously issued financial statements.

1 the date of issuance and *are granted at prices not less than the fair market value of KLA-*
2 *Tencor's common stock at the grant date.*" (Emphasis added.) The Company's 2001 Form
3 10-K also incorporated by reference information contained in the 2001 Proxy Statement
4 regarding Executive Compensation.

5 166. On September 28, 2001, the Company filed a definitive proxy statement with the
6 SEC ("2001 Proxy Statement"). Regarding the "Compensation of Directors," the 2001 Proxy
7 Statement stated that: (a) members of the Board of Directors who are not employees of the
8 Company receive benefits under the 1998 Outside Director Plan; (b) each Outside Director also
9 receives a nonstatutory option to purchase 20,000 shares of common stock as of the date on
10 which such director first becomes an Outside Director; (c) each Outside Director is also granted
11 a nonstatutory option to purchase an additional 10,000 shares of common stock on the date of
12 the subsequent annual meetings on which he or she remains an Outside Director; (d) the term of
13 options granted under the 1998 Outside Director Plan may not exceed ten years; and (e) the
14 1998 Outside Director Plan provides that *"the exercise price shall be equal to the fair market*
15 *value of the Common Stock on the date of grant of the option."* (Emphasis added.) Options
16 granted under the 1998 Director Plan become exercisable immediately upon the date of grant.

17 167. The 2001 Proxy Statement also stated that the Company had granted under the
18 1982 Plan (a) 37,901, 75,800, 65,000 and 30,000 options with an exercise price of \$44.69 to
19 Levy, Schroeder, Dickerson and Neil Richardson ("Richardson"), respectively, on August 11,
20 2000; (b) 18,951, 37,900, 32,500, 15,000 and 10,000 options with an exercise price of \$26.25 to
21 Levy, Schroeder, Dickerson, Richardson and Tompkins, respectively, on November 10, 2000;
22 and (c) 18,951, 37,900, 32,500 and 45,000 options with an exercise price of \$32.75 to Levy,
23 Schroeder, Dickerson and Richardson, respectively, on April 4, 2001. Identified among the
24 *"material terms of the grants"* was the following: *"the exercise price of the options is the fair*
25 *market value of Common Stock as of the date of grant."* (Emphasis added.)

26 168. The 2001 Proxy Statement also identified the 2000 and 1999 Executive
27 Compensation for Levy, Schroeder, Dickerson, Richardson and Tompkins. In 2000, Levy,
28

1 Schroeder, Dickerson, Richardson and Tompkins were granted (among other compensation)
2 90,000, 150,000, 100,000, 50,000 and 10,000 options, respectively. In 1999, Levy, Schroeder,
3 Dickerson, Richardson and Tompkins were granted (among other compensation) 102,136,
4 102,136, 62,882, 87,717 and 50,809 options, respectively.

5 169. The 2001 Proxy Statement stated that *"[a]ctual gains, if any, on option*
6 *exercises are dependent on the future performance of the Company's Common Stock and*
7 *overall market conditions."* (Emphasis added.)

8 170. The 2001 Proxy Statement also contained the Report of the Compensation
9 Committee on Executive Compensation. In pertinent part, the Report provided:

10 *Compensation Philosophy:* The goals of the Company's compensation policy are
11 to attract, retain and reward executive officers who contribute to the overall
12 success of the Company by offering compensation that is competitive in the
13 industry, to motivate executive officers to achieve the Company's business
14 objectives *and to align the interests of executive officers with the long term*
15 *interests of stockholders....*

16 The compensation philosophy of the Compensation Committee is to provide a
17 comprehensive compensation package for each executive officer that is well
18 suited to support accomplishment of the Company's business strategies,
19 objectives and initiatives. *For incentive-based compensation, the Compensation*
20 *Committee considers the desirability of structuring such compensation*
21 *arrangements so as to qualify for deductions available under Section 162(m) of*
22 *the Internal Revenue Code, which disallows a tax deduction for any publicly-*
23 *held corporation for individual compensation exceeding One Million dollars in*
24 *any taxable year for any of the named executive officers, other than*
25 *compensation that is "performance based."* The Compensation Committee
26 applies this compensation philosophy in determining appropriate executive
27 compensation levels and other compensation factors and the Compensation
28 Committee reaches its decisions with a view towards the Company's overall
financial performance.

21 *Executive Officer Compensation:* The Committee's approach is based upon a
22 belief that a substantial portion of aggregate annual *compensation for executive*
23 *officers should be contingent upon the Company's performance* and an
24 individual's contribution to the Company's success. In addition, the Committee
25 strives to align the interests of the Company's executive officers with the long-
26 term interests of stockholders through stock option grants that can result in
27 ownership of the Company's Common Stock. The Committee endeavors to
28 structure each executive officer's overall compensation package to be consistent
with this approach and to enable the Company to attract, retain and reward
personnel who contribute to the success of the Company.

* * *

27 *Long-term Incentives:* Longer term incentives are provided through the Stock
28 Option Plan and the Excess Profit Stock Plan, each of which reward executive

EXHIBIT 4
Part 3 of 5

1 officers through the growth in value of the Company's Common Stock.... ***Stock***
2 ***options are granted at market price on the date of grant and will provide value***
3 ***to the executive officers only when the price of the Company's Common Stock***
4 ***increases over the exercise price.***

5 (Emphasis added.)

6 171. On September 20, 2002, the Company filed a definitive proxy statement and, on
7 September 25, 2002, it filed a revised proxy statement with the SEC (collectively referred to
8 herein as the "2002 Proxy Statement"). Regarding the "Compensation of Directors," the 2002
9 Proxy Statement stated that: (a) members of the Board of Directors who are not employees of
10 the Company receive benefits under the 1998 Outside Director Plan; (b) each Outside Director
11 received a nonstatutory stock option to purchase 20,000 shares of Common Stock as of the date
12 on which such director first became an Outside Director. In fiscal year 2003, the Board
13 approved a change in the amount of the First Option, reducing the size of that grant to 10,000
14 shares of Common stock to be effective when a new Outside Director first joins the Board; (c)
15 each Outside Director is automatically granted a nonstatutory stock option to purchase an
16 additional 10,000 shares of Common Stock on the date of the subsequent annual meetings on
17 which he or she remains an Outside Director; (d) the terms of options granted under the 1998
18 Outside Director Plan may not exceed 10 years; and (e) the 1998 Outside Director Plan provides
19 that ***"the exercise price shall be equal to the fair market value of the Common Stock on the***
20 ***date of grant of the option."*** (Emphasis added.) Options granted under the 1998 Director Plan
21 become exercisable immediately upon the date of grant.

22 172. The 2002 Proxy Statement also stated that, under the 1982 Stock Option Plan,
23 the Company had granted 28,425, 341,100, 105,000, 60,000 and 45,000 options with an
24 exercise price of \$29.31 to Levy, Schroeder, Dickerson, Kispert and Dennis J. Fortino
25 ("Fortino"), respectively, on October 2, 2001. The 2002 Proxy Statement specifically said that
26 these ***"[o]ptions were granted at an exercise price equal to the fair market value of the***
27 ***Company's Common Stock on October 2, 2001."*** (Emphasis added.)

28 173. The 2002 Proxy Statement also reiterated information from the 2001 Proxy
Statement on Executive Compensation for Levy, Schroeder and Dickerson in 2001 and 2000,

1 including the options granted to them in those years. The Executive Compensation section
2 also revealed that (a) during 2001, Kispert and Fortino were granted 80,000 and 90,000
3 options, respectively; and (b) during 2000, Kispert and Fortino were granted 30,000 and
4 60,000 options, respectively.

5 174. The 2002 Proxy Statement stated that *"[a]ctual gains, if any, on option*
6 *exercises are dependent on the future performance of the Company's Common Stock and*
7 *overall market conditions."* (Emphasis added.)

8 175. The 2002 Proxy Statement also included the Report of the Compensation
9 Committee on Executive Compensation, which described its philosophy on Executive Officer
10 compensation and terms concerning Long-term Incentives in language substantially identical
11 to the language in the 2001 Proxy Statement.

12 176. In the section discussing "Stock Options and Incentive Plans," the Company's
13 2002 Form 10-K provided that "KLA-Tencor's stock option program is a broad-based, long
14 term retention program that is intended to attract and retain qualified management and
15 technical employees...*and align stockholder and employee interests....* Under KLA-
16 Tencor's stock option plans, options generally have vesting periods of four or five years, are
17 exercisable for a period not to exceed ten years from the date of issuance and *are granted at*
18 *prices not less than the fair market value of KLA-Tencor's common stock at the grant*
19 *date."* (Emphasis added.) The Company's 2002 Form 10-K also incorporated by reference
20 information contained in the 2002 Proxy Statement regarding Executive Compensation.

21 177. The Company's Q1FY03 Form 10-Q repeated the identical information
22 regarding the purpose of the stock option program and the exercise price of the option grants
23 set forth above from the Company's 2002 Form 10-K.

24 178. The Company's Q2FY03 Form 10-Q repeated the identical information
25 regarding the purpose of the stock option program and the exercise price of the option grants
26 set forth above from the Company's 2002 Form 10-K.

27 179. The Company's Q3FY03 Form 10-Q repeated the identical information
28

1 regarding the purpose of the stock option program and the exercise price of the option grants
2 set forth above from the Company's 2002 Form 10-K.

3 180. On September 23, 2003, the Company filed a definitive proxy statement with
4 the SEC ("2003 Proxy Statement"). Regarding "Director Compensation," the 2003 Proxy
5 Statement provided information that was substantially identical to that provided in the 2002
6 Proxy Statement regarding option grants under the 1998 Outside Director Plan (except that the
7 Outside Directors now receive a nonstatutory stock option to purchase 10,000 shares of
8 common stock as of the date on which such director first becomes an Outside Director).

9 181. The 2003 Proxy Statement also stated that the Company granted (a) 31,450,
10 25,000, 12,500, 12,500 and 12,500 options with an exercise price of \$37.05 to Schroeder,
11 Dickerson, Kispert, Fortino and Wallace, respectively, on November 8, 2002; (b) 62,900,
12 50,000, 25,000, 25,000 and 25,000 options with an exercise price of \$34.67 to Schroeder,
13 Dickerson, Kispert, Fortino and Wallace, respectively, on January 28, 2003; and (c) 1,000
14 options with an exercise price of \$40.14 per share to Dickerson, Fortino and Wallace on May
15 22, 2003. The 2003 Proxy Statement provided that *options were granted at an exercise price*
16 *equal to the fair market value of the Company's common stock.*

17 182. The 2003 Proxy Statement also reiterated information from the 2002 Proxy
18 Statement on Executive Compensation for Schroeder, Dickerson, Kispert and Fortino in 2002
19 and 2001, including the options granted to them in those years. The Executive Compensation
20 section also revealed that, during 2002 and 2001, Wallace was granted 45,000 and 70,000
21 options, respectively.

22 183. The 2003 Proxy Statement stated that *"[a]ctual gains, if any, on option*
23 *exercises are dependent on the future performance of the Company's Common Stock and*
24 *overall market conditions."* (Emphasis added.)

25 184. The 2003 Proxy Statement also included the Report of the Compensation
26 Committee on Executive Compensation which described its philosophy on Executive Officer
27 compensation and terms concerning Long-term Incentives in language substantially similar to
28

1 the language in the 2001 Proxy Statement.

2 185. The 2003 Proxy Statement also provided that, during the fiscal year ended June
3 30, 2002, Tompkins ceased to be an employee of KLA and pursuant to the terms of his options
4 granted under the 1982 Plan, had 30 days to exercise certain options. However, "due to a
5 miscommunication," from KLA, Tompkins was misled as to the expiration date of certain of
6 these options and the independent members of the Board agreed to provide a "one-time cash
7 payment of \$206,800 to him as a remedy for the miscommunication. "The amount paid was
8 measured as 'in the money' value had Mr. Tompkins exercised such options on their
9 expiration date."

10 186. The 2003 Form 10-K repeated the exact information regarding the purpose of
11 the stock option program and the exercise price of the option grants set forth above from the
12 Company's 2002 Form 10-K (except that it stated that options generally have a vesting period
13 of five years). The Company's 2003 Form 10-K also incorporated by reference information
14 contained in the 2003 Proxy Statement regarding Executive Compensation.

15 187. The Company's Q1FY04 Form 10-Q repeated the identical information
16 regarding the purpose of the stock option program and the exercise price of the option grants
17 set forth above from the Company's 2002 Form 10-K (except that it stated that options
18 generally have a vesting period of five years).

19 188. The Company's Q2FY04 Form 10-Q repeated the identical information
20 regarding the purpose of the stock option program and the exercise price of the option grants
21 set forth above from the Company's 2002 Form 10-K (except that it stated that options
22 generally have a vesting period of five years).

23 189. The Company's Q3FY04 Form 10-Q repeated the identical information
24 regarding the purpose of the stock option program and the exercise price of the option grants
25 set forth above from the Company's 2002 Form 10-K (except that it stated that options
26 generally have a vesting period of five years).

27 190. The Company's 2004 Form 10-K repeated the identical information regarding
28

1 the purpose of the stock option program and the exercise price of the option grants set forth
2 above from the Company's 2002 Form 10-K (except that it stated that options generally have a
3 vesting period of five years). The Company's 2004 10-K also incorporated by reference
4 information contained in the 2004 Proxy Statement regarding Executive Compensation.

5 191. On September 9, 2004, the Company filed a definitive proxy statement with the
6 SEC ("2004 Proxy Statement"). Regarding "Director Compensation," the 2004 Proxy
7 Statement provided information that was substantially identical to that provided in the 2003
8 Proxy Statement regarding option grants under the 1998 Outside Director Plan.

9 192. The 2004 Proxy Statement stated that the Company granted (a) 31,450, 25,000,
10 12,500, 12,500 and 12,500 options with an exercise price of \$51.23 to Schroeder, Dickerson,
11 Kispert, Fortino and Wallace, respectively, on July 30, 2003; (b) 60,000, 50,000, 30,000,
12 30,000 and 30,000 options with an exercise price of \$53.86 to Schroeder, Dickerson, Kispert,
13 Fortino and Wallace, respectively, on October 27, 2003; (c) 30,000, 25,000, 15,000, 15,000
14 and 15,000 options with an exercise price of 58.10 to Schroeder, Dickerson, Kispert, Fortino
15 and Wallace, respectively, on January 27, 2004; and (d) 37,500, 31,250, 18,750, 18,750 and
16 18,750 options with an exercise price of \$45.16 to Schroeder, Dickerson, Kispert, Fortino and
17 Wallace, respectively, on April 26, 2004. The 2004 Proxy Statement further revealed that
18 during fiscal year 2004, in order to provide Schroeder with an incentive to remain long-term,
19 he received options covering 83,380 shares of common stock with delayed vesting. The 2004
20 Proxy Statement also stated that options were granted at an exercise price equal to the fair
21 market value of the Company's common stock.

22 193. The 2004 Proxy Statement also reiterated information from the 2003 Proxy
23 Statement on Executive Compensation for Schroeder, Dickerson, Kispert, Wallace and Fortino
24 in 2003 and 2002, including the options granted to them in those years.

25 194. The 2004 Proxy Statement stated that *"[a]ctual gains, if any, on option*
26 *exercises are dependent on the future performance of the Company's Common Stock and*
27 *overall market conditions."* (Emphasis added.)
28

1 195. The 2004 Proxy Statement also included the Report of the Compensation
2 Committee on Executive Compensation which described its philosophy on Executive Officer
3 compensation and terms concerning Long-term Incentives in language substantially similar to
4 the language in the 2001 Proxy Statement.

5 196. The 2004 Proxy Statement also solicited shareholder votes for approval of the
6 Company's 2004 Equity Incentive Plan, including approval of its material terms and
7 performance goals for the purpose of helping awards under the 2004 Equity Incentive Plan
8 qualify as "performance-based" compensation under IRC Section 162(m).

9 197. In discussing the 2004 Equity Incentive Plan, the 2004 Proxy Statement
10 provided that (a) its purposes were to "attract and retain the best available personnel for
11 positions of substantial responsibility, provide additional incentive to our employees and
12 consultants, and promote the success of our business"; (b) options and SARS may not be
13 granted with an exercise price lower than 100% of the fair market value of the underlying
14 shares; and (c) it "prohibits option or stock appreciation right repricing, including by way of
15 an exchange for another award, unless stockholder approval is obtained."

16 198. The 2004 Proxy Statement further stated that "[w]e have designed the 2004
17 Equity Incentive Plan so that it permits us to issue awards that qualify as performance-based
18 under Section 162(m) of the Code."

19 199. In discussing the "Terms and Conditions of Options," (regarding options
20 granted under the 2004 Equity Incentive Plan), the 2004 Proxy Statement provided: "*[t]he*
21 *exercise price of options may not be less than 100% of the fair market value of the common*
22 *stock on the grant date the option [sic]. As our common stock is listed on the Nasdaq*
23 *National Market, the fair market value is the closing sale price for the common stock (or the*
24 *closing bid if no sales were reported) on the grant date.*" (Emphasis added.)

25 200. On October 1, 2004, the Company filed an amendment to its 2004 Proxy
26 Statement ("Amended 2004 Proxy Statement"). Among other things, the Amended 2004 Proxy
27 Statement represented that:
28

1 In the history of the Company, equity compensation has been a critical
2 component of our ability to attract and retain the talent needed in our
3 industry.... ***KLA-Tencor has utilized stock options responsibly in the past***
4 ***and will continue to do so....*** While the new plan results in fewer options
5 available for grant, it also gives the Company much greater flexibility in
6 how we structure equity compensation. We believe this new plan will
7 allow KLA-Tencor to continue attracting high-caliber employees. The
8 2004 Plan would allow us to grant restricted stock, stock appreciation
9 rights, performance shares, performance units and deferred stock units
10 which would give us a range of flexibility in designing competitive
11 packages for our employees while aligning them with increasing
12 shareholder value for you, the Stockholder. The members of our Board of
13 Directors unanimously recommend a vote "FOR" approval of the 2004
14 Equity Incentive Plan.

15 (Emphasis added.)

16 201. The Company's Q1FY05 Form 10-Q repeated substantially identical
17 information regarding the purpose of the stock option program and the exercise price of the
18 option grants set forth above from the Company's 2002 Form 10-K (except that it stated that
19 options generally have a vesting period of five years).

20 202. The Company's Q2FY05 Form 10-Q provided that the "equity incentive
21 program is a broad-based, long-term retention program that is intended to attract and retain
22 qualified management and technical employees...and align stockholder and employee
23 interests.... Under our equity incentive program, stock options generally have a vesting period
24 of five years, are exercisable for a period not to exceed ten years from the date of issuance and
25 are generally ***granted at prices not less than the fair market value of our common stock at***
26 ***the grant date.***" (Emphasis added.)

27 203. The Company's Q3FY05 Form 10-Q repeated the identical information
28 regarding the purpose of the stock option program and the exercise price of the option grants
set forth above from the Company's Q2FY05 Form 10-Q.

204. The Company's 2005 Form 10-K repeated the identical information regarding
the purpose of the stock option program and the exercise price of the option grants set forth
above from the Company's Q2FY05 Form 10-Q. The Company's 2005 10-K also incorporated
by reference information contained in the 2005 Proxy Statement regarding Executive

1 Compensation.

2 205. On October 13, 2005, the Company filed a definitive proxy statement ("2005
3 Proxy Statement") with the SEC. Regarding "Director Compensation," the 2005 Proxy
4 Statement provided information regarding option grants under the 1998 Outside Director Plan,
5 which was substantially identical to that provided in the 2003 Proxy Statement. However,
6 with respect to the subsequent grant (nonstatutory stock option to purchase an additional
7 aggregate 10,000 shares of common stock) the 2005 Proxy Statement stated that it would be
8 provided to each Outside Director in 2,500 share increments each quarter, approximately two
9 business days following the Company's earnings release for the prior fiscal quarter. It further
10 provided that "the Chairman of the Audit Committee receives an additional nonstatutory stock
11 option grant to purchase an additional 2,500 shares of Common Stock on the date of each
12 subsequent annual meeting on which such Director remains the Chairman of the Audit
13 Committee."

14 206. The 2005 Proxy Statement also stated that the Company had granted (a) 22,500,
15 11,250, 11,250, 6,000 and 3,750 options with an exercise price of \$40.66 to Schroeder,
16 Kispert, Wallace, Avi Cohen ("Cohen") and Lance Glasser ("Glasser"), respectively, on
17 August 2, 2004; and (b) 325,800, 75,000, 75,000, 75,000 and 75,000 options with an exercise
18 price of \$41.79 to Schroeder, Kispert, Wallace, Cohen and Glasser, respectively, on September
19 21, 2004.

20 207. The 2005 Proxy Statement also reiterated information from the 2004 Proxy
21 Statement on Executive Compensation for Schroeder, Kispert and Wallace in 2004 and 2003,
22 including the options granted to them in those years. The 2005 Proxy Statement also provided
23 the 2004 and 2003 Executive Compensation for Cohen and Lance. In 2004, Cohen and
24 Glasser were granted (among other compensation) 40,250 and 25,750 options, respectively. In
25 2003, Cohen and Glasser were granted (among other compensation) 18,750 and 13,500
26 options, respectively.

27 208. The 2005 Proxy Statement stated that *"[a]ctual gains, if any, on option*
28

1 *exercises are dependent on the future performance of the Company's Common Stock and*
2 *overall market conditions."* (Emphasis added.)

3 209. The 2005 Proxy Statement also included the Report of the Compensation
4 Committee on Executive Compensation. With respect to "Compensation Philosophy," the
5 2005 Proxy Statement provided, among other things, that it is designed to "(i) attract, retain,
6 and reward Executives who contribute to the overall success of the Company; (ii) support
7 accomplishment of the Company's business strategies, objectives and initiatives; (iii) have a
8 substantial portion of annual compensation be contingent upon the Company's financial
9 performance and an individual's contribution to the Company's success; and (iv) align the
10 interests of Executives with the long term interests of stockholders." With respect to "Long-
11 term Incentives," the Report provided that:

12 Long-term incentives are currently provided under the 2004 Equity Incentive Plan
13 through grants of stock options and restricted stock units. Such awards provide
14 value to Executives through the growth in value of the Company's Common
15 Stock. The Compensation Committee believes that employee equity ownership is
16 highly motivating, provides a major incentive for employees to build shareholder
17 value and serves to align the interests of employees with those of stockholders....
18 *Stock options are granted at market price on the date of grant and will provide*
19 *value to the Executive only when the price of the Company's Common Stock*
20 *increases over the exercise price.*

21 (Emphasis added.)

22 210. In discussing the "Deductibility of Compensation under Internal Revenue Code
23 Section 162(m)," the Report of the Compensation Committee also provided that:

24 The Company's equity compensation programs, including the 2004 Equity
25 Incentive Plan approved by stockholders at the last annual meeting, are structured
26 so that compensation from such programs is "performance based" when earned....
27 Annual incentive compensation has historically not been structured to qualify
28 under Section 162(m). Under Proposal 2 in this Proxy Statement [approving the
162(m) Performance Bonus Plan], the Company's stockholders are being asked to
approve the KLA-Tencor Internal Revenue Code Section 162(m) Performance
Bonus Plan which is structured to qualify incentive compensation as
"performance-based" for fiscal years beginning in 2006.

Compensation paid in fiscal 2005 subject to the Section 162(m) cap is expected to
exceed \$1 million for Mr. Schroeder and Mr. Kispert. The Committee thus
believes that the Company will be subject to limitations on the deductibility of
compensation paid to these named executive officers for fiscal year 2005.

1 211. The Company's Q1FY06 Form 10-Q repeated the identical information
2 regarding the purpose of the stock option program and the exercise price of the option grants set
3 forth above from the Company's Q2FY05 Form 10-Q.

4 212. The Company's Q2FY06 Form 10-Q repeated the identical information
5 regarding the purpose of the stock option program and the exercise price of the option grants set
6 forth above from the Company's Q2FY05 Form 10-Q.

7 213. The Company's Q3FY06 Form 10-Q repeated the identical information
8 regarding the purpose of the stock option program and the exercise price of the option grants set
9 forth above from the Company's Q2FY05 Form 10-Q.

10 **(b) The Reasons Why The Statements Were False And**
11 **Misleading**

12 214. The statements contained in ¶¶165-213 were false and misleading for the
13 following reasons.

14 215. First, the actual grants identified were false and misleading because the options
15 were not granted on the dates identified but, rather, on dates chosen with hindsight for their
16 lower stock prices, as detailed above. Moreover, in recognition that certain of the defendants'
17 option grants identified above were backdated, the Company has announced that it has canceled
18 or repriced their outstanding retroactively priced stock options.

19 216. Second, the statements that options were granted at prices not less than the fair
20 market value of KLA's common stock price on the date of the grant pursuant to the Stock
21 Option Plans were false and misleading because the options were not granted in accordance
22 with such requirements but rather were backdated, as evidenced above.

23 217. Third, the statements that actual gains, if any, on option exercises are dependent
24 on the future performance of the Company's Common Stock and overall market conditions are
25 false and misleading because the backdated options were "in-the-money" (*i.e.*, the exercise
26 price was actually lower than the fair market value on the true date of the grant), as evidenced
27 above.

1 218. Fourth, the statements in KLA's Proxy Statements regarding the Company's
2 philosophy in granting options were false and misleading in that the options were "in-the-
3 money" on the date of the actual grant, as evidenced above.

4 219. Fifth, the statements in KLA's Proxy Statement regarding the Company's
5 compliance with IRC Section 162(m), 28 U.S.C. §162(m), were false and misleading because
6 the Company did not comply with Section 162(m)), as discussed above.

7 220. As a result of these false statements (a) KLA shareholders were misled regarding
8 compensation of the Company's officers and directors, including the specific grants identified
9 in the Proxy Statements; (b) KLA shareholders were misled regarding the integrity of
10 management and the Board of Directors; (c) the election of directors was obtained pursuant to
11 misleading Proxy Statements; (d) the approval of the 2004 Equity Incentive Plan was obtained
12 through a misleading Proxy Statement; and (e) the Performance Bonus Plan was approved
13 through a misleading Proxy Statement.

14 **3. The False and Misleading Statements Regarding Internal Controls**

15 **(a) The Misleading Statements**

16 221. In their Q1FY03 Form 10-Q certification, Schroeder and Kispert each certified
17 that:

18 4. The registrant's other certifying officers and I are responsible for
19 establishing and maintaining disclosure controls and procedures (as defined
20 in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

21 a) designed such disclosure controls and procedures to ensure that
22 material information relating to the registrant, including its consolidated
23 subsidiaries, is made known to us by others within those entities,
24 particularly during the period in which this quarterly reports being
25 prepared;

26 b) evaluated the effectiveness of the registrant's disclosure controls and
27 procedures as of a date within 90 days prior to the filing date of this
28 quarterly report (the "Evaluation Date"); and

 c) presented in this quarterly report our conclusions about the
effectiveness of the disclosure controls and procedures based on our
evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on
our most recent evaluation, to the registrant's auditors and the audit

1 committee of registrant's board of directors (or persons performing the
equivalent function):

2 a) all significant deficiencies in the design or operation of internal
3 process, summarize and report financial data and have identified for the
4 registrant's auditors any material weaknesses in internal controls; and

5 b) any fraud, whether or not material, that involves management or
6 other employees who have a significant role in the registrant's internal
controls; and

7 6. The registrant's other certifying officers and I have indicated in this
8 quarterly report whether or not there were significant changes in internal
9 controls or in other factors that could significantly affect internal controls
subsequent to the date of our most recent evaluation, including any
corrective actions with regard to significant deficiencies and material
weaknesses.

10 (Emphasis added.) Moreover, in Item 4, "Controls and Procedures," the Q1FY03 Form 10-Q
11 provided:

12 Evaluation of disclosure controls and procedures

13 Within 90 days prior to the date of this report (the Evaluation date), the
14 Company's Chief Executive Officer (principal executive officer) and Executive
15 Vice President and Chief Financial Officer (Principal financial officer), carried
16 out an evaluation of the effectiveness of the Company's "disclosure controls and
17 procedures" (as defined in the Securities Exchange Act of 1934 Rules 13a-14(c)
18 and 15(d)-14(c)). ***Based on that evaluation, these officers have concluded that
as of the Evaluation Date, the Company's disclosure controls and procedures
were adequate and designed to ensure that material information relating to the
Company and the Company's consolidated subsidiaries would be made known
to them by others within those entities.*** (Emphasis added.)

19 222. In the Q2FY03 Form 10-Q, Schroeder and Kispert each signed certifications
20 identical to the Q1FY03 Form 10-Q certifications, as cited above. Regarding "Controls and
21 Procedures," the Q2FY03 Form 10-Q repeated the language set forth in the Q1FY03 Form 10-Q
22 but added additional language as underlined:

23 Within 90 days prior to the date of this report (the Evaluation date), the
24 Company's Chief Executive Officer (principal executive officer) and Executive
25 Vice President and Chief Financial Officer (Principal financial officer), carried
26 out an evaluation of the effectiveness of the Company's "disclosure controls and
27 procedures" (as defined in the Securities and Exchange Act of 1934 Rules 13a-
28 14(c) and 15(d)-14(c)). ***Based on that evaluation, these officers have concluded
that as of the Evaluation Date, the Company's disclosure controls and
procedures were adequate and designed to ensure that material information
relating to the Company and the Company's consolidated subsidiaries would be
made known to them by others within those entities, and are effective to ensure***

1 that the information required to be disclosed by us in reports that we file or
2 submit under the Securities Exchange Act of 1934 is recorded, processed and
3 reported within the time periods specified in Securities and Exchange
4 Commission rules and forms. (Emphasis added.)

5 223. In the Q3FY03 Form 10-Q, Schroeder and Kispert each signed certifications
6 substantially identical to the Q1FY03 certifications, as cited above. Regarding "Controls and
7 Procedures," the Q3FY03 Form 10-Q repeated the language set forth in the Q2FY03 Form 10-Q
8 but added additional language as underlined:

9 Within 90 days prior to the date of this report (the Evaluation date), the
10 Company's Chief Executive Officer (principal executive officer) and Executive
11 Vice President and Chief Financial Officer (Principal financial officer) with the
12 participation of other members of management, carried out an evaluation of the
13 effectiveness of the Company's "disclosure controls and procedures" (as defined
14 in the Securities and Exchange Act of 1934 Rules 13a-14(c) and 15(d)-14(c)).
15 Based on that evaluation, these officers have concluded that as of the
16 Evaluation Date, the Company's disclosure controls and procedures were
17 adequate and designed to ensure that material information relating to the
18 Company and the Company's consolidated subsidiaries would be made known
19 to them by others within those entities, and are effective to ensure that the
20 information required to be disclosed by us in reports that we file or submit
21 under the Securities Exchange Act of 1934 is recorded, processed and reported
22 within the time periods specified in Securities and Exchange Commission rules
23 and forms. (Emphasis added.)

24 224. In the 2003 Form 10-K, Schroeder and Kispert each signed certifications
25 substantially identical to the Q1FY03 certifications, as cited above.⁷ Regarding "Controls and
26 Procedures," the 2003 Form 10-K provided:

27 Our management evaluated, with the participation of our Chief Executive Officer
28 and our Chief Financial Officer, the effectiveness of our disclosure controls and
procedures as of the end of the period covered by this Annual Report on Form 10-
K. Based on this evaluation, our Chief Executive Officer and our Chief
Financial Officer have concluded that our disclosure controls and procedures
are effective to ensure that information we are required to disclose in reports
that we file or submit under the Securities Exchange Act of 1934 is recorded,
processed, summarized and reported within the time periods specified in
Securities and Exchange Commission rules and forms. (Emphasis added.)

23 225. In the Q1FY04 Form 10-Q, Schroeder and Kispert each signed certifications
24 substantially identical to the Q1FY03 certifications, as cited above. Regarding "Controls and
25 Procedures," the Q1FY04 Form 10-Q repeated the same information provided in the 2003 Form
26

27 ⁷ Beginning with the 2003 Form 10-K, the certifications referred to Exchange Act Rules 13a-
28 15(e) and 15d-15(e), as opposed to Exchange Act Rules 13a-14 and 15d-14.

1 10-K, except that it represented the information as of the end of the period covered by this
2 Quarterly Report on Form 10-Q.

3 226. In the Q2FY04 Form 10-Q, Kispert signed a certification substantially identical
4 to the Q1FY03 certifications, as cited above. Regarding "Controls and Procedures," the
5 Q2FY04 Form 10-Q repeated the same information provided in the 2003 Form 10-K, except
6 that it represented the information as of the end of the period covered by this Quarterly Report
7 on Form 10-Q.

8 227. In the Q3FY04 Form 10-Q, Schroeder and Kispert each signed certifications
9 substantially identical to the Q1FY03 certifications, as cited above. Regarding "Controls and
10 Procedures," the Q3FY04 Form 10-Q repeated the same information provided in the 2003 Form
11 10-K, except that it represented the information as of the end of the period covered by this
12 Quarterly Report on Form 10-Q.

13 228. In the 2004 Form 10-K, Schroeder and Kispert each signed certifications
14 substantially identical to the Q1FY03 certifications, as cited above. Regarding "Controls and
15 Procedures," the 2004 Form 10-K repeated the same information provided in the 2003 Form 10-
16 K, except that it represented the information as of the end of the period covered by this Annual
17 Report on Form 10-K.

18 229. In the Q1FY05 Form 10-Q, Schroeder and Kispert each signed certifications
19 substantially identical to the Q1FY03 certifications, as cited above. Regarding "Controls and
20 Procedures," the Q1FY05 Form 10-Q repeated the same information provided in the 2003 Form
21 10-K, except that it represented the information as of the end of the period covered by this
22 Quarterly Report on Form 10-Q.

23 230. In the Q2FY05 Form 10-Q, Kispert signed a certification substantially identical
24 to the Q1FY03 certifications, as cited above. Regarding "Controls and Procedures," the
25 Q2FY05 Form 10-Q stated:

26 **Evaluation of Disclosure Controls and Procedures and Related CEO and**
27 **CFO Certifications**

28 We conducted an evaluation of the effectiveness of the design and operation of

1 our disclosure controls and procedures (Disclosure Controls) as of the end of the
2 period covered by this Quarterly Report. The controls evaluation was conducted
3 under the supervision and with the participation of management, including our
4 Chief Executive Officer (CEO) and Chief Financial Officer (CFO). *Based on this
5 evaluation, our CEO and our CFO have concluded that our disclosure controls
6 and procedures are effective to ensure that information we are required to
7 disclose in reports that we file or submit under the Securities Exchange Act of
8 1934 is recorded, processed, summarized and reported within the time periods
9 specified in Securities and Exchange Commission rules and forms.*

10 Attached as exhibits to this Quarterly Report are certifications of the CEO and
11 CFO, which are required in accordance with Rule 13a-14 of the Securities
12 Exchange Act of 1934, as amended (Exchange Act). This Controls and
13 Procedures section includes the information concerning the controls evaluation
14 referred to in the certifications, and it should be read in conjunction with the
15 certifications for a more complete understanding of the topics presented.

16 **Definition of Disclosure Controls**

17 Disclosure Controls are controls and procedures designed to reasonably assure
18 that information required to be disclosed in our reports filed under the Exchange
19 Act, such as this Quarterly Report, is recorded, processed, summarized and
20 reported within the time periods specified in the Securities and Exchange
21 Commission's rules and forms. Disclosure Controls are also designed to
22 reasonably assure that such information is accumulated and communicated to our
23 management, including the CEO and CFO, as appropriate to allow timely
24 decisions regarding required disclosure. Our Disclosure Controls include
25 components of our internal control over financial reporting, which consists of
26 control processes designed to provide reasonable assurance regarding the
27 reliability of our financial reporting and the preparation of financial statements in
28 accordance with generally accepted accounting principles in the U.S. To the
extent that components of our internal control over financial reporting are
included within our Disclosure Controls, they are included in the scope of our
quarterly controls evaluation.

(Emphasis added).

231. In the Q3FY05 Form 10-Q, Schroeder and Kispert each signed certifications
substantially identical to the Q1FY03 certifications, as cited above. Regarding "Controls and
Procedures," the Q3FY05 Form 10-Q repeated the same information provided in the Q2FY05
Form 10-Q, except that it represented the information as of the end of the period covered by this
Quarterly Report on Form 10-Q.

232. In their 2005 Form 10-K Certification, Schroeder and Kispert each certified that:

4. The registrant's other certifying officer(s) and I are responsible for
establishing and maintaining disclosure controls and procedures (as defined
in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over
financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-
15(f)) for the registrant and have:

1 (a) Designed such disclosure controls and procedures, or caused such
2 disclosure controls and procedures to be designed under our supervision, to
3 ensure that material information relating to the registrant, including its
consolidated subsidiaries, is made known to us by others within those
entities, particularly during the period in which this report is being
prepared;

4 (b) Designed such internal control over financial reporting, or caused such
5 internal control over financial reporting to be designed under our
6 supervision, to provide reasonable assurance regarding the reliability of
financial reporting and the preparation of financial statements for external
purposes in accordance with generally accepted accounting principles;

7 (c) Evaluated the effectiveness of the registrant's disclosure controls and
8 procedures and presented in this report our conclusions about the
effectiveness of the disclosure controls and procedures, as of the end of the
period covered by this report based on such evaluation; and

9 (d) Disclosed in this report any change in the registrant's internal control
10 over financial reporting that occurred during the registrant's most recent
11 fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual
12 report) that has materially affected, or is reasonably likely to materially
affect, the registrant's internal control over financial reporting; and

13 5. The registrant's other certifying officer(s) and I have disclosed, based
14 on our most recent evaluation of internal control over financial reporting, to
the registrant's auditors and the audit committee of the registrant's board of
directors (or persons performing the equivalent functions):

15 (a) All significant deficiencies and material weaknesses in the design or
16 operation of internal control over financial reporting which are reasonably
likely to adversely affect the registrant's ability to record, process,
summarize and report financial information; and

17 (b) Any fraud, whether or not material, that involves management or other
18 employees who have a significant role in the registrant's internal control
over financial reporting.

19
20 Regarding "Controls and Procedures," the 2005 Form 10-K provided substantially similar
21 information provided in the Q2FY05 Form 10-Q regarding the Evaluation of Disclosure
22 Controls and Procedures and the Definition of Disclosure Controls, except that it referenced
23 Rules 13a-15(e) and 15d-15(e) under the Exchange Act when discussing Disclosure Controls
24 and represented the information as of the end of the period covered by this Annual Report on
25 Form 10-K.

26 233. In the Q1FY06 Form 10-Q, Schroeder and Kispert each signed certifications
27 substantially identical to the 2005 Form 10-K certifications, as cited above. Regarding
28

1 “Controls and Procedures,” the Q1FY06 Form 10-Q provided that:

2 **Evaluation of Disclosure Controls and Procedures and Related CEO and**
3 **CFO Certifications**

4 We conducted an evaluation of the effectiveness of the design and operation of
5 our disclosure controls and procedures (Disclosure Controls) as of the end of the
6 period covered by this Quarterly Report. The controls evaluation was conducted
7 under the supervision and with the participation of management, including our
8 Chief Executive Officer (CEO) and Chief Financial Officer (CFO). *Based on this*
9 *evaluation, our CEO and our CFO have concluded that our disclosure controls*
10 *and procedures were effective as of the end of the period covered by this*
11 *Quarterly Report to ensure that information we are required to disclose in*
12 *reports that we file or submit under the Securities Exchange Act of 1934 is*
13 *recorded, processed, summarized and reported within the time periods specified*
14 *in the Securities and Exchange Commission rules and forms.*

15 (Emphasis added.) In all other respects, the information provided was substantially similar to
16 that provided in the Q2FY05 Form 10-Q.

17 234. In the Q2FY06 Form 10-Q, both Wallace and Hall each signed certifications
18 substantially identical to the 2005 Form 10-K certifications, as cited above. Regarding
19 “Controls and Procedures,” the Q2FY06 Form 10-Q provided substantially similar information
20 to that provided in the Q1FY05 Form 10-Q, except that it represented the information as of the
21 end of the period covered by this Quarterly Report on Form 10-Q.

22 235. In the Q3FY06 Form 10-Q, both Wallace and Hall each signed certifications
23 substantially identical to the 2005 Form 10-K certifications, as cited above. Regarding
24 “Controls and Procedures,” the Q3FY06 Form 10-Q provided substantially similar information
25 to that provided in the Q1FY05 Form 10-Q, except that it represented the information as of the
26 end of the period covered by this Quarterly Report on Form 10-Q.

27 **(b) The Reasons Why These Statements Were False and**
28 **Misleading**

29 236. The statements contained in ¶¶221-235 were false and misleading because (a)
30 the SEC filings did not identify deficiencies or material weaknesses in the internal controls
31 relating to option grants accounting and reporting; (b) the SEC filings did not disclose the
32 fraudulent scheme alleged herein; (c) no proper evaluation and report were ever conducted by

1 the certifying officers for the purpose of identifying and eliminating internal control problems;
2 and (d) defendants wholly failed to maintain effective internal controls over financial reporting
3 designed to provide reasonable assurance regarding the reliability of financial reporting and the
4 preparation of financial statements for external purposes in accordance with GAAP as required
5 by Public Company Accounting Oversight Board Auditing Standard No. 2, ¶7.

6 237. The lack of sound internal controls and the existence of deficiencies and material
7 weaknesses are evidenced by the Company's own admissions.

8 238. In its 2006 Form 10-K, the Company has admitted that:

9 *As a result of the Special Committee investigation, the Company identified*
10 *certain material weaknesses in its internal control over financial reporting in*
11 *periods ending prior to June 30, 2006.* Before June 30, 2002, the Company did
12 not have sufficient safeguards in place to monitor its control practices regarding
13 stock option pricing and related financial reporting and to foster an effective flow
14 of information between those responsible for stock option pricing and those
15 responsible for financial reporting. Inadequate training, communication and
16 coordination in and among the Company's human resources, stock administration,
17 legal and finance functions prevented the Company from assuring that stock
18 options were priced and accounted for correctly, primarily from July 1, 1997 to
19 June 30, 2002.

20 In addition, the stock option pricing process during that time period was overly
21 dependent on certain former executive officers of the Company, and was
22 administered by a stock option committee that was not always properly
23 constituted and sometimes acted outside the scope of the authority delegated to it
24 by the Company's Board of Directors. *The individual who served as the*
25 *Company's Chief Executive Officer during part of that time period and*
26 *continuing until midway through the last fiscal year, was involved in the past*
27 *retroactive pricing of stock options. To that extent, the material weaknesses in*
28 *the Company's internal control over financial reporting continued until*
midway through the Company's fiscal year ended June 30, 2006.

(Emphasis added.)

22 239. The fact that the certifying officers did not conduct proper evaluations and failed
23 to report and remedy material weaknesses in control is also evidenced by the following facts.

24 240. First, the pervasiveness of the backdating and internal control deficiencies
25 described by the Company creates a strong inference that, had a proper review been conducted,
26 the certifying officers would have uncovered that the Company lacked the proper internal
27 controls necessary to, among other things, prevent defendants from engaging in the fraudulent
28

1 backdating and ensure that the stock options were properly accounted for and reported in the
2 Company's financial statements. Indeed, had a review been conducted, the problems would
3 have been revealed as they were when the Special Committee conducted its internal
4 investigation.

5 241. Second, the fact that the certifying officers – in particular Schroeder and Kispert
6 – abused the lack of the internal controls in order to effectuate and profit from the fraud
7 evidences their failure to conduct a proper investigation of the internal controls.

8 **B. DEFENDANTS ENGAGED IN A SCHEME TO DEFRAUD**

9 242. The conduct alleged above also gives rise to liability under Rule 10b-5(a) and
10 (c). Defendants are liable as participants in a scheme, plan and course of conduct to backdate
11 options that began in the 1990s and continued throughout the Class Period. This backdating
12 scheme operated as a fraud and deceit on Lead Plaintiffs and the other Class members by failing
13 to disclose material facts and misleading them regarding (a) the Company's financial results; (b)
14 officer and director compensation; (c) the Company's compliance with its own internal policies
15 and stock option plans; (d) the Company's compliance with tax laws; and (e) the integrity of
16 management.

17 243. As detailed below, defendants each knowingly or with deliberate recklessness
18 committed manipulative or deceptive acts in furtherance of the scheme including (a) causing
19 and/or permitting the manipulation of stock option grants by, *inter alia*, the setting of
20 retroactively selected exercise prices for option grants in order to understate compensation
21 expenses and personally obtain larger than reported compensation; (b) exercising backdated
22 options and selling the shares obtained therefrom; (c) preparing, approving and signing SEC
23 filings that overstated the Company's results and understated its expenses and tax liabilities in
24 its financial results; (d) preparing, approving and signing SEC filings that understated and
25 misrepresented officer and director compensation; (e) failing to properly withhold taxes when
26 employees exercised options; and/or (f) taking steps to ensure that the Company lacked sound
27 internal controls and contained deficiencies and material weaknesses.

1 **1. Defendants' Manipulation of Option Grants and KLA's Stock**
2 **Purchase Plan**

3 244. As noted above, the Company has conceded in its Restatement that options
4 granted to officers, directors and employees were "retroactively" priced such that the "option
5 exercise price was not the market price of the option shares on the actual grant date of the
6 option, but instead was a lower market price on an earlier date."

7 245. The Compensation Committee Defendants and the members of the Stock Option
8 Committee (Schroeder, Nichols, Hall, Kispert, Urbanek, Marks, Dickerson, Barnholt, Bond,
9 Tompkins and possibly other defendants) each backdated the option grants for the principal
10 purpose of furthering the fraudulent scheme as evidenced by the following facts.

11 246. First, in its 2006 Form 10-K, the Company concluded that "[t]he individual who
12 served as the Company's Chief Executive Officer during part of that time period and continuing
13 until midway through the last fiscal year, was involved in the past retroactive pricing of
14 options." Based on the Company's reporting of officers, it is clear that this individual is
15 Schroeder.

16 247. Second, Schroeder, Nichols, Hall, Kispert, Dickerson and Tompkins were
17 members of or attendees at meetings of the Stock Option Committee where decisions were
18 made as to what grants should be approved and what the grant dates should be, as evidenced by
19 the Company's own acts and admissions and statements by Confidential Witnesses who
20 prepared agendas and reports for meetings of the Stock Option Committee.

21 (a) In its 2006 Form 10-K, *the Company admitted that Schroeder and*
22 *Tompkins were members of the Company's Stock Option Committee* from 1994 through fall
23 2006 and from mid-1997 through mid-1999, respectively. According to its 2006 Form 10-K,
24 the Company suspended this Stock Option Committee in fall 2006 as it conducted its
25 investigation into the backdating. *The Company further stated that "the stock option pricing*
26 *process during that time period...was administrated by a stock option committee that was not*
27 *always properly constituted and sometimes acted outside the scope of the authority delegated*
28

1 *to it by the Company's Board of Directors.*" (Emphasis added.)

2 (b) While CW #5 could not recall the identity of every executive who was a
3 member of the Stock Option Committee and attended its meetings ("Stock Option Committee
4 Meetings"), CW #5 stated that it definitely included the following persons: Schroeder, Nichols,
5 Hall, Kispert and the Company's senior corporate counsel, Kim Jackson. CW #5 was aware of
6 this fact because he/she was involved in creating the agendas for some of the meetings. While
7 he/she could not recall precisely how often the Stock Option Committee convened or what
8 topics were identified in the agendas, he/she believed it met quarterly.

9 (c) CW #4 confirmed that the Stock Option Committee Meetings occurred
10 quarterly and that Schroeder and Dickerson attended these meetings. CW #4 was aware of
11 these facts because, in his/her capacity as an employee in the human resources department,
12 he/she helped prepare quarterly spreadsheets identifying grants for executives and employees at
13 all levels of the Company and containing information such as the type of grant (*i.e.*, new hire,
14 employee promotion, annual (focal) performance review or retention), employee name,
15 employee hire date, employee title and number of shares being recommended, which were then
16 submitted to the Stock Option Committee ("Option Spreadsheets").

17 (d) CW #4 explained that the Stock Option Committee made the decisions
18 regarding the option dates and price data. Specifically, CW #4 stated that, while these Option
19 Spreadsheets were prepared under the direction of Nyberg (the director of compensation and
20 benefits), the *Compensation Department did not include share price data or grant dates on*
21 *these spread sheets prior to sending them to the Stock Option Committee. Rather, the Stock*
22 *Option Committee returned the Option Spreadsheets to the Compensation Department with*
23 *the option grant dates and stock prices information completed after their meeting.*

24 (e) CW #4 further stated that Option Spreadsheets were returned to the
25 Compensation Department with the signatures of either Schroeder or Dickerson.

26 248. Third, as detailed in ¶¶34-37 above, the Compensation Committee Defendants
27 (Urbanek, Marks, Barnholt and Bond) participated in decisions regarding the options grants
28

1 including the setting of option grant dates and exercise prices.

2 249. The Director Defendants (Wallace, Schroeder, Urbanek, Marks, Barnholt, Bond,
3 Bingham, Elkus, Morton, Kaufman, Levy and Tompkins) each approved the backdating of
4 options grants. As detailed in ¶¶34-35, 58, 72-89, each Director Defendant was ultimately
5 responsible for administering and deciding the terms of the option grants – including the grant
6 date – and for ensuring compliance with the Option Plans. Indeed, CW #7 confirmed that,
7 while the Compensation Committee was charged with actually awarding the stock and date that
8 it was based on,” “procedurally, the board had to meet and they had to approve [grants].”

9 250. Defendants also engaged in a related scheme to defraud in connection with the
10 Company’s Employees Stock Purchase Plan. Although the Company does not provide any
11 details regarding this scheme, it does concede in its 2006 Form 10-K that the Company needed
12 to record “additional non-cash adjustments...relating primarily to the accounting for employee
13 stock purchase plans.” CW #8 provides an explanation of manipulation regarding the employee
14 stock purchase plan.

15 251. The Second Amended and Restated 1981 Employee Stock Purchase Plan (“Stock
16 Purchase Plan”) provides that employees can purchase KLA stock through payroll deductions
17 during six-month “Purchase Periods.” On the last day of each Purchase Period, employees are
18 entitled to buy KLA stock at 85% of the lower of (a) the closing stock price on the first day of
19 said six-month Purchase Period or (b) the closing stock price on the last day of said six-month
20 Purchase Period. Under APB No. 25, the 15% discount (an IRS limit) was permitted and the
21 plan was considered “non-compensatory” and, thus, there was no compensation expense to
22 report.

23 252. However, according to CW #8, the Company implemented an additional step to
24 the Stock Purchase Plan. Specifically, the Company would assign each employee who
25 purchased stock on the last day of the Purchase Period a “term number.” This term number
26 enabled the employee to later change the purchase price for such shares. The higher the term
27 number (1-5), the more time an employee had to change their share price. Although he/she
28

1 could not recall with any certainty, CW #8 thought that the term number "5" granted an
2 employee a two-and-a-half-year window to change the price of their shares and the term
3 number "1" granted the employee a two-or-three-month window. CW #8 provided the
4 following example of what occurred: if an employee purchased their shares at \$50 in January
5 2003 and the price dropped to \$45 in March 2003, then the price of the shares purchased by the
6 employee in January would have been changed to \$45, assuming that the employee's term
7 window was still open in March 2003.

8 **2. Defendants' Manipulative And Deceptive Exercise Of Backdated**
9 **Options**

10 253. As detailed in ¶¶312-313 herein, during the Class Period, Wallace, Schroeder,
11 Kaufman, Levy, Tompkins, Dickerson, Hall, Kispert, Urbanek, Marks, Barnholt, Bond, Elkus,
12 Bingham, Morton and Nichols each knowingly and/or recklessly exercised options that were
13 backdated (either prior to or during the Class Period) and/or sold the resulting shares for the
14 primary purpose of furthering the fraudulent scheme. These trades constitute manipulative and
15 deceptive acts in furtherance of the fraudulent scheme.

16 **3. Defendants' Manipulative And Deceptive Understating of Expenses,**
17 **Improper Tax Treatment of Options And Misrepresentation Of The**
Company's Financial Results

18 254. As detailed above, defendants reported inflated net income figures for KLA by
19 failing to properly account for stock options made to KLA senior officers, directors and
20 employees. Specifically, KLA's expenses were understated and income was overstated due to
21 the Company's failure to record the compensation expense from the backdated stock options
22 that were granted to officers, directors and employees and its improper tax treatment of the
23 options.

24 255. Each of the defendants took manipulative and deceptive acts in connection with
25 the issuance of such misleading statements for the principal purpose of furthering this scheme
26 by preparing, approving or signing the SEC filings that understated and misrepresented officer
27 and director compensation:
28

1 (a) Kispert, Hall and Boehlke held the position of CFO. Hall was also Vice
2 President of Finance and Accounting prior to becoming CFO. As such, they were responsible
3 for the preparation of the Company's financial statements and for ensuring that the periodic
4 reports filed with the SEC containing such financial statements complied fully with the
5 disclosure requirements of the federal securities laws.

6 (b) Schroeder, Kispert, Wallace and Hall all signed certifications for various
7 quarterly or fiscal year-end financial statements pursuant to SOX. By signing the certifications
8 pursuant to SOX, Schroeder, Kispert, Wallace and Hall have certified that (i) the Company's
9 annual and quarterly reports fully complied with the requirements of the Exchange Act, as
10 amended; (ii) the information contained in the annual reports fairly presented, in all material
11 respects, KLA's financial condition and results; (iii) the quarterly and annual reports contained
12 no misstatements or omissions of material fact; (iv) they attested to the accuracy of the
13 Company's financial reports and sufficiency of the internal controls; and (v) they had disclosed
14 all instances of fraud involving management or other employees who had a significant role in
15 the Company's internal control over financial reporting.

16 (c) Wallace, Schroeder, Hall, Kispert, Urbanek, Marks, Barnholt, Bond,
17 Bingham, Elkus, Morton, Kaufman, Levy and Tompkins all signed various quarterly or fiscal
18 year-end financial statements during the Class Period.

19 (d) Each of the Officer Defendants (Wallace, Schroeder, Dickerson, Kispert,
20 Hall, Boehlke and Nichols) was responsible for ensuring the accuracy of the reporting of the
21 Company's financial results, as set forth in ¶¶28-29 above.

22 (e) According to KLA's Audit Committee Charter, each Audit Committee
23 Defendant (Bingham, Bond, Elkus and Kaufman) oversaw the accounting and financial
24 reporting process of the Company and the audits of the financial statements of the Company and
25 assisted the Board with, among other things, the oversight and monitoring of the integrity of the
26 Company's financial statements and the Company's compliance with legal and regulatory
27 requirements.

28

1 **4. Defendants' Participation In The Understating And**
2 **Misrepresentation Of Officer And Director Compensation**

3 256. As discussed above, KLA's annual Proxy Statements for fiscal years 2001
4 through 2005 contained false statements about the compensation of KLA's officers and
5 directors because they stated, among other things, that the exercise price of the stock options is
6 equal to the price of the stock on date of the grant. Because of these false statements,
7 shareholders were misled when they were asked to approve the Company's 2004 Equity
8 Incentive Plan, approve a Performance Bonus Plan and vote for directors.

9 257. Each of the defendants committed manipulative and deceptive acts in connection
10 with the issuance of these and other false and misleading statements regarding officer and
11 director compensation for the principal purpose of furthering this scheme. Indeed, as officers
12 and directors, the Individual Defendants had a duty to disseminate complete, accurate and
13 truthful information about KLA's executive and director compensation. The Individual
14 Defendants had a duty to promptly correct any public statements issued by KLA that had
15 become false and misleading. The Individual Defendants were involved in the drafting,
16 producing, reviewing and/or dissemination of the false and misleading statements alleged
17 herein. Moreover, as alleged in ¶¶34-37, 43-46 above, the Company's charters expressly state
18 that members of the Compensation Committee Defendants and the Audit Committee
19 Defendants had responsibilities for the proxy statements.

20 **5. Defendants' Manipulative And Deceptive Acts Regarding The**
21 **Company's Tax Withholding Obligations**

22 258. In addition to failing to properly report its tax liabilities, the Company also
23 violated tax laws by failing to properly withhold tax liabilities upon the exercise of options as
24 required by IRC §422.

25 259. The September 6, 2006 testimony of Linda Thomsen, Director of the SEC's
26 Division of Enforcement, before the U.S. Senate Committee on Finance explained the
27 withholding obligations:
28

1 When an employee exercises a non-statutory option, the difference between the
2 exercise price and the fair market value of the company's stock on the date of
3 exercise is treated as ordinary compensation and the employee is generally taxed
4 on the gain at his or her ordinary income tax rates. The company incurs employee
5 withholding obligations on this gain, but also is entitled to an associated tax
6 deduction on the gain. When companies backdate option grants to a lower
7 exercise price, employees can obtain a larger taxable gain upon the exercise of an
8 NSO and companies can obtain a correspondingly larger tax deduction and
9 withholding obligation on that gain.

10 Unlike the exercise of NSOs, incentive stock options, or ISOs, afford employees
11 favorable tax treatment because any gain at exercise is not taxed as ordinary
12 income, although the gain may be subject to alternative minimum tax.
13 Accordingly, a company does not obtain any corresponding tax deduction (or
14 incur withholding obligations) at the time of exercise. In addition, if an employee
15 holds the stock for the statutory holding period prior to sale - one year after
16 exercise and two years after grant - then the sale is considered a "qualifying
17 disposition" and the entire gain on sale is taxed at favorable capital gains rates.
18 However, among the statutory requirements of ISOs is that they be granted at-the-
19 money. An ISO that is granted in-the-money loses its favorable status and instead
20 is treated under the tax code as a non-statutory option (NSO), including ordinary
21 income recognition by the employee on any gain at exercise and a corresponding
22 tax deduction by the company on that gain. Backdating allows an employee to
23 treat what is in fact a non-qualified option as an incentive stock option, which can
24 result in the employee underpaying taxes while causing the company to lose the
25 tax deduction to which it otherwise would have been entitled.

26 260. Specifically, for a stock option to qualify as an Incentive Stock Option ("ISO")
27 (and thus receive the special tax treatment described above under IRC Section 421(a)), it must
28 meet the requirements of IRC Section 422 when granted and at all times beginning from the
grant until its exercise. Under IRC Section 422, the option price must equal or exceed the fair
market value of the underlying stock at the time of the grant, *i.e.*, the option cannot be in-the-
money when granted. A backdated stock option that has been granted at a discount, therefore,
would violate one of the requirements that apply to ISOs and would not qualify as an ISO.

261. If the requirements for an ISO have not been followed, the option will be treated
under the tax rules as a non-qualified option. ISOs are subject to taxation only upon the sale of
the stock. Non-qualified options, however, are subject to income tax and Federal Insurance
Contributions Act ("FICA") withholding upon exercise. The backdated stock options granted
to KLA officers, directors and employees did not qualify as ISOs because they were granted at a
discount and, therefore, they should have been classified as non-qualified options.

1 262. Because the backdated stock options constituted non-qualified options, KLA was
2 liable for the income tax and payments under FICA that it failed to withhold upon the
3 recipient's exercise of the discounted options. Defendants, as well as others, exercised options
4 during the Class Period that were granted between the mid-1990s and 2003 (§312) – the period
5 during which options were backdated. Accordingly, KLA should have, but failed to, withhold
6 monies when these backdated options were exercised.

7 263. The Company's 2006 Form 10-K strongly supports an inference that KLA issued
8 ISOs that were disqualified because of the backdated option prices, but failed to withhold monies:

9 Because virtually all holders of retroactively priced options issued by the
10 Company were not involved in or aware of the retroactive pricing, *the Company*
11 *has taken and intends to take certain actions to deal with the adverse tax*
12 *consequences that may be incurred by the holders of retroactively priced*
13 *options*. The adverse tax consequences are that retroactively priced stock options
14 vesting after December 31, 2004 ("409A Affected Options") subject the option
15 holder to a penalty tax under IRC Section 409A (and, as applicable, similar
16 penalty taxes under California and other state tax laws). One such action by the
17 Company is to offer to amend the 409A Affected Options to increase the exercise
18 price to the market price on the actual grant date or, if lower, the market price at
19 the time of the amendment. The amended options would not be subject to
20 taxation under IRC.

21 * * *

22 Another action is to approve bonuses payable to holders of the amended options
23 to compensate them for the resulting increase in their option exercise price. The
24 amount of these bonuses would be effectively repaid to the Company if and when
25 the options are exercised and the increased exercise price is paid (but there is no
26 assurance that the options will be exercised). *Finally, the Company intends to*
27 *compensate certain option holders who have already exercised 409A Affected*
28 *Options for the additional taxes they incur* under IRC Section 409A (and, as
applicable, similar state tax laws).

Three of the Company's option holders were subject to the December 31, 2006
deadline described above. Accordingly, in December 2006, the Company offered
to amend the 409A Affected Options held by Mr. Wallace, the Company's Chief
Executive Officer, and two former executive officers to increase the exercise
price so that these options will not subject the option holder to a penalty tax under
IRC Section 409A. All three individuals accepted the Company's offer. In
addition, the Company agreed to pay each of the three individuals a cash bonus in
January 2008 equal to the aggregate increase in the exercise prices for his
amended options. For Mr. Wallace, the amount of this bonus is \$0.4 million. The
Company plans to take similar actions with respect to the outstanding 409A
Affected Options granted to non-officers as soon as possible after the filing of this
Report. *The Company estimates that the total cash payments needed to deal*
with the adverse tax consequences of retroactively priced options granted to
non-officers will be approximately \$30 million.

1 (Emphasis added.) *See also* Form 8-K filed on February 27, 2007, described in ¶295 below.

2 **6. Defendants' Failure To Establish Sound Internal Controls And**
3 **Allow Deficiencies And Material Weaknesses**

4 264. As noted above, the Company has conceded in its Restatement that the
5 Company lacked sound internal controls and that its internal controls contained deficiencies
6 and material weaknesses.

7 265. Each of the Individual Defendants was responsible for ensuring that the
8 Company had proper internal controls and took steps in furtherance of the fraudulent scheme
9 by ensuring that the Company's internal controls were deficient even while expressly
10 representing that such controls were adequate:

11 (a) Schroeder, Kispert, Wallace and Hall all signed certifications for various
12 quarterly or fiscal year-end financial statements pursuant to SOX. By signing the certifications
13 pursuant to SOX, these defendants certified that they are responsible for establishing and
14 maintaining proper controls, have taken (with the participation of management) certain steps to
15 ensure that internal controls are sufficient and have reported all significant deficiencies.
16 Moreover, as set forth above, Schroeder, Kispert, Wallace and Hall have each certified that the
17 Company's internal controls were adequate, effective and designed to ensure that material
18 information relating to the Company and the Company's consolidated subsidiaries would have
19 been known to them by others within those entities.

20 (b) The Officer Defendants were responsible under Section 110.03 of the
21 AICPA for adopting sound accounting policies and establishing and maintaining internal
22 controls consistent with management's assertions in the Company's financial statements, as set
23 forth in ¶28. The Company's own filings confirm that management was responsible for
24 establishing and maintaining a system for internal controls and the financial reporting process,
25 as set forth in ¶29.

26 (c) According to the Audit Committee Charter, the Audit Committee
27 Defendants were responsible for overseeing the Company's accounting and financial reporting
28

1 processes, reviewing on a continuous basis the adequacy of the Company's systems of internal
2 controls, as set forth in ¶¶43-44.

3 (d) According to the Nominating Committee Charter, the Nominating
4 Committee Defendants were responsible for developing and recommending to the Board of
5 Directors a set of corporate governance principles and for evaluating the governance of the
6 Board of Directors, as set forth in ¶¶54-55.

7 (e) The Director Defendants were also ultimately responsible for the
8 Company's internal accounting and financial controls, as set forth in ¶¶34, 43-44, 54-55, 58.

9 **C. THE TRUTH BEGINS TO EMERGE**

10 266. On May 22, 2006, *The Wall Street Journal* carried a front-page story analyzing
11 the stock options that a few companies, including KLA, granted to its top executives. The
12 article explained that, in 2001, KLA granted Levy and Schroeder two batches of stock options:
13 (a) the first dated at the share price's yearly first-half low and (b) the second at its yearly
14 second-half low. In all, the article states that Levy had received ten grants from KLA and its
15 predecessor company between 1994 and 2001 – all preceding quick run-ups in the share price.
16 *The Wall Street Journal* further reported that “Mr. Levy has reaped at least \$6 million from
17 cashing out options” while “Mr. Schroeder has pocketed at least \$10 million.”

18 267. Merrill Lynch also issued a report on May 22, 2006 analyzing the options grant
19 timing for the semiconductor and semiconductor equipment companies in the Philadelphia
20 Semiconductor Index. Covering the period from 1997 through 2002, Merrill Lynch's analysis
21 revealed that KLA's stock generated average annualized excess return of 800% for the 20 days
22 following options grants, ranking second out of the 16 companies studied. Merrill Lynch
23 specifically identified that the following suspicious stock option grants were made to Levy,
24 Schroeder, Kispert and Wallace: (a) 4/30/1997 at \$22.25 per option; (b) 7/31/1997 at \$30.28 per
25 option; (c) 8/31/1998 at \$10.63 per option; (d) 10/23/1998 at \$16.97 per option; (e) 10/27/1999
26 at \$16.88 per option; (f) 8/11/2000 at \$44.69 per option; (g) 11/10/2000 at \$26.25 per option;
27 (h) 4/4/2001 at \$32.75 per option; (i) 10/2/2001 at \$29.31 per option; and (j) 11/8/2002 at
28

1 \$37.05 per option.

2 268. At a conference on May 22, 2006, CFO Hall announced that the DOJ had served
3 the Company with a subpoena requesting stock option grant data related to its stock option
4 grants and announced that the Company had formed an independent committee to investigate its
5 stock option grants over the past ten years.

6 269. After the May 22, 2006 disclosures raising the possibility of an options
7 backdating scheme, *the common stock price fell 10.39% from \$45.24 per share on May 19,*
8 *2006 to close at \$40.54 per share on May 22, 2006 on heavy volume of 13,615,220 shares*
9 *traded, which was three times the average trading volume for the prior three months.* On
10 May 23, 2006, KLA's stock fell again by 3.6% or \$1.46 to close at \$39.07 per share on heavy
11 volume of 11,193,220 shares traded.

12 270. Analysts also reacted to these revelations by issuing reports expressing specific
13 concerns regarding the backdating issue:

14 (a) Analyst D. Kaplan at Standard & Poor's downgraded the stock to a "sell"
15 from a "strong buy."

16 (b) On May 22, 2006, analyst Robert Maire at Needham & Co. downgraded
17 KLA's stock to "hold" from a "buy," stating that the stock will likely be under significant
18 pressure for a period of time due to the stock option controversy.

19 (c) A.G. Edwards Analyst Gavin Duffy downgraded KLA to "hold" from
20 "buy" on May 23, 2006, stating that "[w]ith the current environment where investors are skittish
21 about the possibility of any corporate scandal, we believe shares of KLA-Tencor will be range
22 bound at best until the current investigation is completed and the situation has closure in one
23 form or another." Duffy continued: "We feel that investors are better advised to remain on the
24 sidelines in the near terms until we get a better sense of how this investigation will turn out."

25 271. Over the next eight months, the Company started to make some admissions
26 about liability, which in some instances were also misleading, and attempted to limit the blame
27 to certain former executives, as discussed below.

28

1 (Emphasis added.) The stock price fell again in reaction to this June 30, 2006 announcement.
2 On June 30, 2006, the stock closed at \$41.57 per share, a decline of 1% or \$0.42 from the
3 previous trading day's closing price.

4 276. The stock options controversy at KLA continued to impact the recommendations
5 of analysts in the following weeks:

6 (a) On July 12, 2006, in his report on KLA, analyst Patrick J. Ho of Stiffel
7 Nicolaus ("Ho") maintained a "hold" rating for the Company based on a concern about the
8 stock options issue: "While the company's fundamental remains among the best of the industry
9 (market position, business model, order growth), we believe that some level of overhang
10 remains due to questions surrounding its past stock option grants to Chairman Kenneth Levy."
11 In the wake of this report, the stock fell from \$42.56 per share on July 11, 2006 to \$40.99 per
12 share on July 12, 2006, representing a \$1.56 or 3.7% drop in the price of the stock. The
13 Company's stock continued to fall on July 13, 2006, closing at \$40.50 per share.

14 (b) In a July 26, 2006 report, Ho maintained his "hold" rating due, in part, to
15 KLA's June 30, 2006 announcement: "Recently, the company announced that on a preliminary
16 basis, an appointed special committee did find some 'irregularities' in its past stock option grant
17 policy. While this issue does not have any impact on near-term fundamentals, we believe there
18 is risk related to the credibility of the company and this issue could create a continuing
19 overhang on the stock until the matter is completely resolved." Following the Company's
20 fourth quarter conference call on July 27, 2006, Ho maintained his "hold" rating, stating in his
21 July 28, 2006 report: "[T]here remains a cloud hanging over the company related to its past
22 stock options policy and the ongoing investigation by an independent committee."

23 277. On July 24, 2006, after the close of the market, the Company issued a press
24 release announcing that it would delay releasing results for the fourth quarter and 2006 fiscal
25 year ended June 30, 2006 pending completion of the internal investigation into stock option
26 grants. The press release also reiterated the Special Committee's preliminary results. The next
27 day, the stock price fell another \$0.03 to \$39.80.

28

1 278. After the market closed on July 27, 2006, the Company issued a press release
2 entitled "KLA-Tencor Reports Q4 2006 Revenue of \$579 Million Fiscal Year 2006 Revenue
3 \$2.1 Billion." In this release, KLA announced selected financial results for its fourth quarter
4 and reiterated that, "[a]s a result of the on-going investigation and the potential for restatement,
5 the Company is unable to provide detailed GAAP or non-GAAP financials for the quarter or
6 year ended June 30, 2006. In addition, the Company will not file its annual report on Form 10-
7 K until after the completion of the investigation. The Company does not expect the
8 investigation to be completed until after the date the Form 10-K is required to be filed."

9 279. On September 13, 2006, after the close of the market, KLA filed Notification of
10 Late Filing with the SEC, disclosing that it would not timely file its Form 10-K due to its
11 ongoing stock options investigation. The stock price fell from \$46.11 on September 13, 2006 to
12 \$45.96 on September 14, 2006.

13 280. On September 14, 2006, the Company issued a press release entitled "KLA-
14 Tencor Delays Filing Form 10-K And Receives Notice From NASDAQ." In this release, the
15 Company explained that it received a NASDAQ Staff Determination notice indicating that the
16 Company is not in compliance with the filing requirements for continued listing as set forth in
17 NASDAQ Marketplace Rule 4310(c)(14) and that its common stock is subject to delisting from
18 the NASDAQ Global Select Market. The Company also stated that it is focused on resolving
19 the backdating issues as quickly as possible and plans to file its Form 10-K as soon as
20 practicable following completion of the Special Committee's investigation. The stock price fell
21 again on September 15, 2006 from \$45.96 to \$45.44.

22 281. On September 28, 2006, the Company issued a pre-market open press release
23 entitled "KLA-Tencor Will Restate Financial Statements Related to Stock Options." In the
24 press release, the Company revealed that *KLA's financial statements dating back to July 1,*
25 *1997 should no longer be relied upon and certain financial results will have to be restated*
26 *because incorrect measurement dates for certain stock option grants were used:*

27 KLA-Tencor Corporation (NASDAQ: KLAC) today announced that *it will restate*
28 *previously issued financial statements to correct the Company's past*

1 *accounting for stock options. Based on a report received from a Special*
2 *Committee of the Board of Directors, the Board concluded that incorrect*
3 *measurement dates for certain stock option grants were used for financial*
4 *accounting purposes, principally during the periods July 1, 1997 through*
5 *June 30, 2002. As a result, the Company will be required to record non-cash*
6 *charges for compensation expenses relating to those past stock option grants.*

7 The Company has not determined the exact amount of such charges, the resulting
8 tax and accounting impact, or which specific reporting periods may require
9 restatement. Accordingly, the Company is filing a Form 8-K today stating that the
10 financial statements and all earnings and press releases and similar
11 communications issued by the Company relating to periods beginning on or after
12 July 1, 1997, should no longer be relied upon. KLA-Tencor intends to file its
13 restated financial results and Annual Report on Form 10-K as quickly as
14 practicable.

15 (Emphasis added.) In response to this announcement, the stock price fell \$0.27 from \$44.74 to
16 \$44.47 on September 29, 2006.

17 282. Shortly before the close of the stock market on October 3, 2006, the Company
18 filed a SEC Form 8-K providing additional details regarding the restatements and revealed, for
19 the first time, that KLA believed that the restatement of previous financial statements would be
20 “*material.*” The stock fell \$0.20 from \$44.05 on October 2, 2006 to \$43.85 on October 3, 2006.

21 283. On October 5, 2006, Analysts Gary Hsueh and Srinu Sundararajan of CIBC
22 World Markets stated in their report that the stock options “overhang” on the KLA would
23 continue: “In our view, pending restatement due to options is the bigger issue.” The report also
24 drew attention to KLA’s risk of NASDAQ de-listing because of the Company’s likely failure to
25 file its 2006 Form 10-K by the deadline imposed by the SEC as a results of to the Company’s
26 ongoing internal investigation and financial restatement: “Despite ongoing communication with
27 NASDAQ in anticipation of this issue, such a risk on an \$8B market cap stock could drive P/B
28 and forward P/E multiples BELOW the prior, purely fundamental driven, trough in valuation.”
The report further stated that the “more tangible risk of NASDAQ de-listing could drive shares
to the low \$30-range.”

29 284. After the close of the market on October 16, 2006, the Company issued a press
30 release (expressly incorporated into its October 18, 2006 Form 8-K filed with the SEC) entitled
31 “KLA-Tencor Announces Results of Special Committee Investigation of Historical Stock
32

1 Option Practices,” *revealing that the restatements to correct accounting for stock-based*
2 *compensation would result in additional non-cash charges of up to \$400 million.*

3 285. On October 17, 2006, before the market opened, the Company issued a press
4 release entitled “KLA-Tencor Announces Retirement of Board Chairman Kenneth Levy”
5 (expressly incorporated into its October 18, 2006 Form 8-K filed with the SEC). In this release
6 the Company also stated that, “[b]ased upon that investigation, the Company intends to re-price
7 all outstanding retroactively priced options held by Mr. Levy and certain other former and
8 current executives of the Company. The exercise price of each re-priced option will be
9 increased to the fair market value on the corrected measurement date.” Following the October
10 16 and 17 news, the stock price fell \$1.22 or 2.46% on October 17, 2006, closing at \$48.32 per
11 share. On October 18, 2006, the stock fell \$1.91 or 3.96% to close at \$46.29 per share.

12 286. Analysts continued to comment on the materiality of the options backdating
13 scheme at KLA and reacted to the Company’s misleading assertions that current management
14 had no responsibility for the fraud:

15 (a) On October 16, 2006, Analysts Michael J. O’Brien, Michael D. Winters
16 and Andrew J. Liersch of Bears, Stearns & Co. Inc. issued a report citing KLA’s disclosures
17 regarding the restatement of previous financial statements and the completion of the internal
18 investigation. The report highlighted that (i) the total cash charge of the financial restatements
19 is expected to be \$400 million; (ii) the current company management was not involved in the
20 improper stock option practices; (iii) the stock option grants to Kispert would be re-priced; (iv)
21 CEO Schroeder was terminated and all of his outstanding options would be cancelled; and (v)
22 Nichols had resigned and all of his outstanding options held by him would be re-priced. The
23 report stated that: “In our view, this should help eliminate the overhang on the stock and it can
24 begin to trade on fundamental again.” Analysts at Citigroup and Edwards also issued reports on
25 October 16, 2006 which reiterated these disclosures made by the Company.

26 (b) On October 17, 2006, Analyst Patrick J. Ho of Stiffle Nicolaus issued a
27 report relying upon the Company’s announcement attributing all the wrongdoing to a few
28

1 defendants: “[t]he company announced that there was no involvement in these improper stock
2 option practices by any current members of the executive management team, including Rick
3 Wallace (CEO), John Kispert (President and COO, and former CFO) and Jeff Hall (CFO).
4 Based on this announcement, it appears that the stock options in question were tied to those of
5 Mr. Schroeder. We believe this announcement reduces a significant overhang on the stock, and
6 given that current management team (Mr. Wallace, Mr. Kispert and Mr. Hall) was not
7 implicated, we believe this also re-establishes the credibility among these key participants with
8 investors.”

9 287. On December 27, 2006, the Company announced the resignation of Tompkins
10 from the Board of Directors effective December 21, 2006. The stock fell \$0.32 on December
11 28, 2006, closing at \$49.89 per share.

12 288. More surprising admissions by KLA were to come. In a Form 8-K filed with the
13 SEC before the market opened on January 5, 2007, KLA admitted that certain outstanding
14 options have exercise prices below the fair market value of the Company’s common stock on
15 the actual date on which those particular options were granted and the exercise prices for those
16 options were set at the fair market value of the common stock on an earlier date when the fair
17 market value was lower. KLA further admitted that, to the extent the back-dated options were
18 not vested as of December 31, 2004, it had violated IRC Section 409A. In that same filing, the
19 Company announced specific steps to off-set the illicit benefit received by some of the
20 defendants. KLA re-priced the back-dated stock options of Wallace, Richardson and Fortino by
21 increasing the per share exercise price to the fair market value of the common stock on the
22 actual grant dates of the options. On this news, the stock price increased slightly on January 5,
23 2007, closing up \$0.10 per share at \$50.15 per share.

24 289. On January 29, 2007, the Company issued its 2006 Form 10-K wherein it
25 restated previously filed financial results for fiscal years 2005, 2004, 2003 and 2002. KLA also
26 revealed even more damning facts regarding the fraud, including the fact that the backdating of
27 the option grants and corresponding public misrepresentations were not the result of inadvertent
28

1 error but rather intentional misconduct and that documents were falsified in furtherance of this
2 fraud. The key admissions regarding the nature of the fraudulent acts are as follows:

- 3 • ***“[C]ertain of our stock options, primarily those granted from July 1, 1997 to June 30,***
4 ***2002, had been retroactively priced for all employees who received these grants***
5 This means that the option exercise price was not the market price of the option shares
6 on the actual grant date of the option, but instead was a lower market price on an earlier
7 date. The actual grant date – when the essential actions necessary to grant the option
8 were completed, including the final determination of the number of shares to be granted
9 to each employee and the exercise price – is the correct measurement date to determine
10 the market price of the option shares under the accounting rules in effect at the time.”
11 (Emphasis added.)
- 12 • “[T]here was retroactive pricing of stock options granted to all employees who received
13 options, primarily during the periods from July 1, 1997 to June 30, 2002”
- 14 • ***“[T]he retroactively priced options were not accounted for correctly in our previously***
15 ***issued financial statements”*** (Emphasis added.)
- 16 • “to correct our past accounting for stock options, we recorded additional pre-tax, non-
17 cash, stock-based compensation expense of ***(a) \$348 million for the periods July 1,***
18 ***1994 to June 30, 2005 under APB Opinion No. 25 and (b) \$22 million for the year***
19 ***ended June 22, 2006 under SFAS No. 123(R).*** We expect to amortize an additional \$6
20 million of such pre-tax charges...in future periods” (Emphasis added.)
- 21 • ***“[T]he retroactive pricing of options involved the falsification of Company records,***
22 ***resulting in erroneous statements being made in financial and other reports***
23 ***previously filed with the SEC,*** as a well as in information previously provided to our
24 independent registered public accounting firm” (Emphasis added.)
- 25 • “[I]n most instances, the retroactive pricing of options violated the terms of our stock
26 option plans....”
- 27 • ***“[W]e identified past material weaknesses in our internal controls and procedures***
28 A material weakness is a control deficiency, or combination of them, that results in more
than a remote likelihood that a material misstatement in our financial statements will not
be prevented or detected.” (Emphasis added.)
- “The discovery that we had retroactively priced stock options (primarily from July 1,
2007 to June 30, 2002) and had not accounted for them correctly has had, and may
continue to have, a material adverse effect on our financial results.”
- “The ongoing government inquiries relating to our historical stock option practices are
time consuming and expensive and could result in injunctions, fines and penalties that

1 may have a material adverse effect on our financial condition and results of operations.”

- 2 • “The Special Committee investigation and restatement activities have required us to
3 expend significant management time and incur significant accounting, legal, and other
4 expenses. The resulting restatements have had a material adverse effect on our results of
5 operations....”
- 6 • “[T]he retroactive pricing of options was intentional, not inadvertent or through
7 administrative error” (Emphasis added.)
- 8 • “[T]he retroactive pricing of options involved the selection of fortuitously low exercise
9 prices by certain former executive officers, and other former executives may have been
10 aware of this conduct”
- 11 • *“The individual who served as the Company’s Chief Executive Officer during part of
12 that time period and continuing until midway through the last fiscal year, was
13 involved in the past retroactive pricing of stock options.”* (Emphasis added.) *Based
14 on public filings, the individual who held these positions was Schroeder.*
- 15 • Under the “Findings and Remedial Actions” section of the Form 10-K, the Company
16 stated that, “[a]s a result of the Special Committee investigation, on October 16, 2006,
17 we terminated our employment relationship and agreement with Kenneth L. Schroeder,
18 and we announced our intent to cancel all outstanding stock options held by Mr.
19 Schroeder that were retroactively priced or otherwise improperly granted. Those
20 options were canceled in December 2006.... Accordingly, in the second quarter of
21 fiscal 2007 the Company will reverse approximately \$20 million of the non-cash, stock-
22 based compensation recorded in prior periods. ... ”
- 23 • Under the “Findings and Remedial Actions” section of the Form 10-K, the Company
24 reiterated that Nichols had resigned in fall 2006 and stated that the Company and
25 Nichols had entered into a “Separation Agreement and General Release under which Mr.
26 Nichols’ outstanding retroactively priced stock options have been re-priced by
27 increasing the exercise price to the market price of the option shares on the actual grant
28 date. The exercise price of each re-priced option was increased to the market price on
the actual grant date. Under SFAS No. 123(R), no incremental charge will be recognized
in the financial statements for the quarter ended December 31, 2006.”
- Under the “Findings and Remedial Actions” section of the Form 10-K, the Company
reiterated that Levy had resigned in fall 2006 and stated that the Company and Levy had
entered into a “Separation Agreement and General Release under which Mr. Levy’s
outstanding retroactively priced stock options have been re-priced by increasing the
exercise price to the market price of the option shares on the actual grant date.... The
exercise price of each re-priced option was increased to the market price on the actual
grant date. Under SFAS No. 123(R), no incremental charge will be recognized in the
financial statements for the quarter ended December 31, 2006.”

- 1 • Under the “Findings and Remedial Actions” section of the Form 10-K, the Company
2 announced that Tompkins had resigned on December 21, 2006 in fall 2006 and stated
3 that the Company “agreed to modify the outstanding options held by Mr. Tompkins (all
4 of which were fully vested) to extend the post-termination exercisability period to
5 December 31, 2007, which is the last day of the calendar year in which those options
6 would have terminated in the absence of such extension....”
- 7 • The U.S. Department of Labor is conducting an examination of KLA’s 401(k) Savings
8 Plan.

9 290. Significantly, it appears that defendants’ misconduct went beyond the stock
10 option manipulation fraud. In the 2006 Form-10K, the Company also revealed that:

11 *“[i]n addition to restating the consolidated financial statements in response to*
12 *the Special Committee’s findings, the Company is recording additional non-*
13 *cash adjustments that were previously considered to be immaterial relating*
14 *primarily to the accounting for employee stock purchase plans, corrections for*
15 *the recognition of deferred tax assets, the release of tax reserves, the timing of*
16 *revenue recognition, gains and losses on hedging contracts and the calculation*
17 *of minority interest....”*

18 (Emphasis added.)

19 291. On February 9, 2007, KLA filed its Q2FY07 Form 10-Q, which includes
20 restatements for condensed consolidated financial statements for its quarter ended
21 December 31, 2006 (and related disclosures). In its Q2FY07 Form 10-Q, KLA admitted that it
22 “did not record the required stock-based compensation expenses under SFAS No. 123(R)
23 related to our retroactively priced options in our previously issued financial statements for our
24 quarter ended December 31, 2005, and that is why we are restating them in this filing.” *KLA*
25 *further stated that “[t]o correct our past accounting for stock options, in total we have*
26 *recorded additional pre-tax, non-cash, stock-based compensation expense of (a) \$348 million*
27 *for the periods July 1, 1994 to June 30, 2005 under APB Opinion No. 25 and (b) \$28 million*
28 *for the period from July 1, 2005 through December 31, 2006 under SFAS No. 123(R).”*

(Emphasis added.) The Company also said that it “will later restate our previously filed
financial statements for the quarter ended March 31, 2006 when included in our Quarterly
Report on Form 10-Q for the quarter ended March 31, 2007.”

29 292. In its Q2FY07 Form 10-Q, the Company further clarified that “[m]anagement
30 agrees with the Special Committee that there was retroactive pricing of stock options to all

1 option holders” KLA stated that, “[i]n addition to restating the consolidated financial
2 statements in response to the Special Committee’s findings, the Company recorded additional
3 non-cash adjustments [for the quarter ended December 31, 2005] that were previously
4 considered to be immaterial relating primarily to the accounting for employee stock purchase
5 plans, corrections for the recognition of deferred tax assets, the release of tax reserves, the
6 timing of revenue recognition, gains and losses on hedging contracts and the calculation of
7 minority interest.” The Company also revealed that, on February 2, 2007, it learned “that the
8 SEC has opened a formal investigation into these matters.”

9 293. In its Q2FY07 Form 10-Q, the Company further stated that:

- 10 • As a result of terminating Mr. Schroeder, “vesting of Mr. Schroeder’s then
11 outstanding stock options and restricted stock awards immediately ceased, and the
12 890,914 unvested option shares and 100,000 unvested restricted stock award shares
13 held by Mr. Schroeder at the time of termination were canceled. Accordingly, in the
14 second quarter of fiscal 2007 we reversed \$20 million of the non-cash, stock-based
15 compensation charges that had been recorded in prior periods In December 2006,
16 we canceled 596,740 vested option shares held by Mr. Schroeder as of the time of
17 termination, representing those shares that had been retroactively priced or otherwise
18 improperly granted.”
- 15 • “During the three months ended December 31, 2006 and 2005, we recorded stock-
16 based compensation expense of \$16.1 million (net of a \$20 million reversal of stock-
17 based compensation charges for our former Chief Executive Officer) and \$38.8
18 million, respectively. During the six months ended December 31, 2006 and 2005, we
19 recorded stock-based compensation expense of \$53.1 million (net of a \$20 million
20 reversal of stock-based compensation charges for our former Chief Executive
21 Officer) and \$78.6 million.”

22 294. On February 27, 2007, KLA filed a definitive proxy statement with the SEC
23 (“2006 Proxy Statement”). In the section titled “About the Board of Directors and Its
24 Committees” under “The Board of Directors,” the 2006 Proxy Statement states in part:

25 In addition to the three standing Committees, in May 2006 the Board
26 appointed a Special Committee, consisting of Mr. Bingham and Mr.
27 Kaufman, to conduct an independent investigation of the Company’s
28 historical stock option practices, and in the fall of 2006, the Board of
Directors appointed a Special Litigation Committee, consisting of Mr.
Kaufman and Mr. Wang, to conduct an independent investigation of the
claims asserted in the related stockholder derivative actions and to
determine the Company’s position with respect to those claims.

In the section titled “Report of the Compensation Committee on Executive Compensation”

1 under "Deductibility of Compensation Under Internal Revenue Code Section 162(m)" the
2 2006 Proxy Statement states in part:

3 The Company's existing equity compensation plans, including the 2004
4 Equity Incentive Plan, are structured so that the compensation deemed paid
5 to an executive officer in connection with the exercise of stock options
6 granted under those plans should qualify as performance-based
7 compensation not subject to the \$1 million limitation. However, the
8 Company has determined that certain of its past stock options were
9 retroactively priced and, therefore, have exercise prices below the fair
10 market values of the underlying shares on the grant dates of the options.
11 Because retroactively priced options do not qualify as performance-based
12 compensation, the compensation deemed paid when those options are
13 exercised is subject to the Section 162(m) limitation. *As a result, a
14 substantial portion of the compensation realized by Mr. Kispert in
15 connection with his option exercises during fiscal year 2006 is subject to
16 the Section 162(m) limitation. In addition, other awards made under
17 those plans may or may not qualify as performance-based compensation.*

18 (Emphasis added.) This section of the 2006 Proxy Statement further states:

19 Until fiscal year 2006, the Company's annual cash incentive programs were
20 not designed to provide bonus payments that would qualify as performance-
21 based compensation under Section 162(m). However, at the 2005 annual
22 meeting, the stockholders approved a new Performance Bonus Plan
23 structured in a manner that will allow the Company to qualify all or part of
24 the compensation earned under that plan as performance-based
25 compensation not subject to the \$1 million limit on deductibility under
26 Section 162(m). As a result, a substantial portion of the incentive
27 compensation earned by the executive officers under that plan for fiscal
28 year 2006 should qualify as performance-based compensation not subject to
the Section 162(m) limitation. However, a portion of the incentive
compensation earned by certain executive officers for fiscal year 2006 is
not expected to constitute performance-based compensation under Section
162(m), and that portion, when added to other non-performance based
compensation earned for fiscal year 2006, is expected to exceed the \$1
million limit under Section 162(m) for Mr. Wallace, Mr. Kispert and
possibly other executive officers."

29 295. On February 27, 2007, the Company filed a Form 8-K announcing that:

30 On February 27, 2007, KLA-Tencor Corporation (the "Company")
31 commenced a formal tender offer to its employees that will allow them to
32 tender for amendment or replacement certain outstanding options under the
33 Company's Restated 1982 Stock Option Plan, 2000 Nonstatutory Stock
34 Option Plan and 2004 Equity Incentive Plan. The options subject to the
35 offer have been determined, as a result of a lengthy investigation of the
36 Company's past option grant practices, to have exercise prices based on the
37 fair market value per share of its common stock on a date earlier than the
38 actual dates on which those options were granted. As a result, those options
have exercise prices below the fair market value of the Company's common
stock on the grant date.

1 Section 409A of the Internal Revenue Code provides that options granted
2 with a below-market exercise price, to the extent unvested as of
3 December 31, 2004, will be subject to adverse income taxation, unless
4 certain remedial action is taken before those options are exercised. The
5 offer is designed to allow employees the opportunity to avoid those tax
6 consequences by offering to amend or replace each of their Section 409A-
7 covered options. If such an option is tendered for amendment pursuant to
8 the offer, then the exercise price of that option will, on the next business
9 day following the expiration date of the offer, be adjusted to the lower of
10 (i) the fair market value per share of the Company's common stock on the
11 date on which that option was actually granted or (ii) the closing selling
12 price per share of its common stock on the date on which the option is
13 amended pursuant to the offer (the "Adjusted Exercise Price").

14 **D. ADDITIONAL *SCIENTER* ALLEGATIONS**

15 296. As alleged herein, defendants acted with *scienter* in that they (a) had access to all
16 internal data concerning the Company's stock option plans; (b) directed and/or participated in
17 establishing the terms of the option grants, including the choice of grant dates and exercise
18 price; (c) knew or with deliberate recklessness disregarded that the public documents and
19 statements issued or disseminated in the name of the Company were materially false,
20 incomplete or misleading; (d) knew or with deliberate recklessness disregarded that such
21 statements or documents would be issued or disseminated to the investing public; and (e)
22 knowingly or with deliberate recklessness participated or acquiesced in the issuance or
23 dissemination of such statements or documents as primary violations of the federal securities
24 laws.

25 297. Additional facts provide actual and strong circumstantial evidence of defendants'
26 *scienter* including: (a) the Company's concessions and admissions; (b) defendants' roles,
27 responsibilities for granting and administering option grants, including their specific attendance
28 at meetings where options were backdated; (c) defendants' desire to boost compensation when
KLA lacked the funds to pay salaries or give pay raises; (d) defendants' desire to personally
obtain greater compensation without public scrutiny; and (e) the pervasiveness and nature of the
fraud.

1 **1. The Company's Own Admissions And Recent Actions Establish**
2 **Defendants' *Scienter***

3 298. Most notably, the Company has made admissions and taken actions that
4 establish, without resort to circumstantial evidence, the *scienter* of the Company and numerous
5 Individual Defendants:

6 (a) In the fall of 2006 and in its 2006 Form 10-K, the Company admitted that
7 options were backdated. Indeed, in its 2006 Form 10-K, the Company explained that "*certain*
8 *of our stock options, primarily those granted from July 1, 1997 to June 30, 2002, had been*
9 *retroactively priced for all employees who received these grants* This means that the option
10 exercise price was not the market price of the option shares on the actual grant date of the
11 option, but instead was a lower market price on an earlier date." (Emphasis added.)

12 (b) In its 2006 Form 10-K, the Company conceded that "*the retroactive*
13 *pricing of options was intentional, not inadvertent or through administrative error.*"
14 (Emphasis added.)

15 (c) The Company's statement that the backdating occurred "primarily" prior
16 to 2002 is a tacit admission that some backdating occurred after 2002, which is after SOX
17 changed the requirements for reporting option grants. After August 29, 2002, option grants had
18 to be reported to the SEC within two days of the grant. The fact that the options misconduct
19 occurred after this SOX provision was enacted suggests a knowing violation of securities laws
20 or at least severe recklessness.

21 (d) In its 2006 Form 10-K, the Company concluded that "[t]he individual
22 *who served as the Company's Chief Executive Officer during part of that time period and*
23 *continuing until midway through the last fiscal year, was involved in the past retroactive*
24 *pricing of stock options.*" (Emphasis added.) Based on the Company's reporting of officers, it
25 is clear that this individual is Schroeder.

26 (e) In its 2006 Form 10-K, the Company stated that, "[a]s a result of the
27 *Special Committee investigation*, on October 16, 2006, *we terminated our employment*
28

1 *relationship and agreement with [defendant] Schroeder*, and we announced *our intent to*
2 *cancel all outstanding stock options held by Mr. Schroeder* that were retroactively priced or
3 otherwise improperly granted.” According to KLA, these options were allegedly canceled in
4 December 2006.

5 (f) After the Special Committee finished its investigation, the Company
6 announced resignations by Nichols, Levy and Tompkins and the re-pricing of all outstanding
7 retroactively priced stock options held by Nichols and Levy to the correct fair market value on
8 the corrected measurement date.

9 **2. Defendants’ Specific Participation In The Backdating Establish**
10 **Their *Scienter***

11 299. The Company also concluded that “the stock option pricing process during that
12 time period was overly dependent on certain former executive officers of the Company, and was
13 administered by a stock option committee that was not always properly constituted....” As
14 described above, Schroeder, Nichols, Hall, Kispert and Dickerson, and possibly other
15 defendants, were members of the Stock Option Committee and/or attended meetings at which
16 employee and executive stock option grants were approved and grant dates assigned during the
17 Class Period. Tompkins was also a member of this committee between mid-1997 and 1999,
18 during which time the backdating of option grants also occurred.

19 300. As alleged above, the members of the Stock Option Committee and the
20 Compensation Committee Defendants (Schroeder, Nichols, Hall, Kispert, Urbanek, Marks,
21 Dickerson, Barnholt, Bond and Tompkins) each participated in the actual selection of backdated
22 grant dates for the principal purpose of furthering the fraud.

23 301. From the beginning, the Company has attempted to minimize the fall-out from
24 the disclosure of its fraud by placing blame entirely on a couple of defendants and exonerating
25 the Company’s current management. This effort has been effective as analysts expressed relief
26 over this fact. However, for the reasons alleged herein, the facts do not support this
27 exoneration.

EXHIBIT 4
Part 4 of 5

1 302. Most significantly, the Board of Directors has taken overt actions to prevent any
2 independent investigation into the details of who was behind or who participated in this
3 admitted fraud by obtaining a signed agreement from the one key employee who allegedly has
4 intimate knowledge of the facts, prohibiting her from speaking with anyone about the options-
5 related fraud. As described above, CW ##6 and 7 and others confirmed that Nyberg would be
6 the one former employee other than defendants who had direct contact with senior executives
7 and would have personal knowledge of the key issues relating to alleged backdating. According
8 to CW #7, Nyberg would analyze stock options, make recommendations as to who got what,
9 present to the Board regarding what the executives should get and present to the executives
10 what the rank and file should get. In fact, CW #7 described Nyberg as the “woman who had the
11 first ringside seat for a decade” and “is totally where all the coffins got buried.” Yet, Nyberg,
12 who is no longer employed by KLA, informed plaintiffs’ counsels’ representatives that she
13 could not speak with them because the Company has instructed her not to speak with anyone
14 and her husband clarified that Nyberg had executed a written agreement with the Board of
15 Directors prohibiting her from speaking to anyone regarding KLA. Moreover, unlike other
16 companies, KLA has not publicly disclosed the report issued by its Special Committee.

17 303. In addition, several Confidential Witnesses confirmed that defendants were very
18 involved in all aspects of the Company. CW #7 described KLA as a company “that was run
19 from the top down. Every division had to report personally to the CEO every quarter.” CW #7
20 further stated that the Company was run as a “dictatorship” and that Schroeder and Levy, “the
21 Kens” “ran this company with an iron fist.” CW #2 also noted that Schroeder “ran everything”
22 and that Dickerson also exercised power at the Company.

23 **3. Defendants’ Efforts To Recruit And Retain Executives And**
24 **Employees Supports A Strong Inference Of *Scienter***

25 304. In the highly volatile market for technology companies, the granting of stock
26 options is often a company’s strongest means for obtaining skilled labor. Indeed, according to
27 CW #6, the Company hired Iquantic to conduct an analysis of KLA’s benefits program in 2001.

1 In connection with this analysis, Iquantic surveyed KLA's employees and learned that the
2 employees wanted to take home cash. Thus, the compensation department began to strategize
3 on how to provide employees with more cash without raising their salaries and the Company
4 executives, including defendants here, sought to "optimize" the benefits from stock options by
5 any means possible.

6 305. A number of witnesses and documents evidence the fact that, as of at least 2000,
7 the Company lacked the ability to properly compensate employees with cash.

8 (a) According to CW #6, KLA was not doing well financially in 2002 and
9 2003 so it implemented a pay freeze.

10 (b) CW #8 confirmed that when he/she started at the Company in 2003,
11 he/she was informed that the Company had been having financial problems and had not given
12 employees raises during the prior few years.

13 (c) CW #3 stated that in 2001 KLA was experiencing "money troubles" and
14 informed all employees that they would not be receiving raises. CW #3 further stated that, in
15 spring or summer 2001, all employees at the supervisory level and above were asked to take pay
16 cuts (although vice presidents received 10% raises for their annual merit increase in 2001).

17 (d) CW #1 stated that KLA was "running its business based on options" and
18 that "instead of spending real money on salary and bonuses, they would give options."

19 (e) A presentation slide titled "Q1 Focus" (page 28) from the "Human
20 Resources Executive Review dated June 26, 2001 – Tom Coffey" identifies one of the action
21 steps as "Decrease Management Salaries effective 7/1/01."

22 (f) A presentation slide titled "Q1 Status Update Compensation" (page 18)
23 from the "Human Resources Executive Review dated September 19, 2001 – Tom Coffey" states
24 that the HR Department has "Processed Management Salary Decreases." The slide also
25 confirms that "All salary actions require Compensation approval."

26 (g) A presentation slide titled "Q2 Status Update Compensation" (page 28)
27 from the "Human Resources Executive Review dated December 10, 2001 – Tom Coffey" states
28

1 that "Salary increases for FY02 cancelled."

2 306. Thus, the Company offered employees additional stock options during the pay
3 freeze or in exchange for pay cuts.

4 (a) CW #6 stated that the Company asked employees to accept stock options
5 in exchange for pay cuts.

6 (b) The presentation slide titled "Q4 Status Update" (page 26) from the
7 "Human Resources Executive Review dated June 26, 2001 – Tom Coffey" states that (i) "2nd
8 Supplemental [stock options] Approved for Officers, communicated and implemented into
9 stock system"; and (ii) "Recommended and received approval for 2nd Supplemental Focal
10 Stock Option."

11 (c) The presentation slide titled "Q2 Status Update Compensation" (page 28)
12 from the "Human Resources Executive Review dated December 10, 2001 – Tom Coffey" also
13 states that (i) "Focal stock issued at 150%"; and (ii) "Developed, presented and received
14 approval for proposal to issue 100 share option to employees without Focal stock." The slide
15 further indicates that there was "[p]ositive feedback regarding stock" for both these action steps.

16 307. Defendants' willingness to manipulate option grants as a means of boosting
17 compensation for themselves and employees is further evidenced by their practice of "re-
18 pricing" stock options that were "out-of the-money," that is, where the stock price fell below
19 the exercise price.

20 **4. Defendants' Personal Enrichment Through Lucrative Stock Option**
21 **Grants And Insider Trading Further Supports A Finding Of**
Scienter

22 308. Defendants were motivated to commit the fraudulent scheme in order to reap
23 significant personal profits. Defendants provided themselves with a direct form of
24 compensation, which amounted to undisclosed and unaccounted for compensation in a number
25 of ways.

26 309. First, the Individual Defendants each personally obtained backdated options.
27 The following charts set forth the options granted to certain defendants prior to and during the
28

Class Period as reported in the Company's Proxy Statements and Form 4's filed with the SEC:

July 26, 1994 - Fiscal 1995

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Ken Levy	7/26/94	\$9.31	\$9.12	\$9.06	\$11.24	240,000
Ken Schroder	7/26/94	\$9.31	\$9.12	\$9.06	\$11.24	240,000

April 18, 1995 - Fiscal 1995

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
John Kispert	4/18/95	\$15.31	\$15.00	\$14.70	\$16.56	2,440

September 17, 1996 - Fiscal 1997

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
John Kispert	9/17/96	\$10.94	\$10.72	\$8.70	\$12.19	3,000

October 8, 1996 - Fiscal 1997

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
John Kispert	10/8/96	\$10.81	\$10.59	\$8.88	\$12.80	2,625
Gary Dickerson	10/8/96	\$10.81	\$10.59	\$8.88	\$12.80	12,750
Ken Levy	10/8/96	\$10.81	\$10.59	\$8.88	\$12.80	125,000

July 21, 1997 - Fiscal 1998

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Dean Morton	7/21/1997	\$27.38	\$26.82	\$23.88	\$33.01	5,000
Richard Elkus	7/21/1997	\$27.38	\$26.82	\$23.88	\$33.01	5,000

June 15, 1998 - Fiscal 1998

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Dean Morton	6/15/98	\$12.78	\$12.52	\$12.22	\$19.01	5,000

August 31, 1998 - Fiscal 1999

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Richard Wallace	8/31/98	\$10.63	\$10.41	\$10.41	\$15.83	9,251
John Kispert	8/31/98	\$10.63	\$10.41	\$10.41	\$15.83	22,600
Gary Dickerson	8/31/98	\$10.63	\$10.41	\$10.41	\$15.83	41,921
Ken Schroder	8/31/98	\$10.63	\$10.41	\$10.41	\$15.83	125,000
Ken Levy	8/31/98	\$10.63	\$10.41	\$10.41	\$15.83	204,272
Jon Tompkins	8/31/98	\$10.63	\$10.41	\$10.41	\$15.83	60,595

October 23, 1998 - Fiscal 1999

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Gary Dickerson	10/23/98	\$16.97	\$16.63	\$10.53	\$20.21	65,449
Jon Kispert	10/23/98	\$16.97	\$16.63	\$10.53	\$20.21	30,135

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Ken Levy	10/23/98	\$16.97	\$16.63	\$10.53	\$20.21	220,728
Ken Schroder	10/23/98	\$16.97	\$16.63	\$10.53	\$20.21	220,728
Jon Tompkins	10/23/98	\$16.97	\$16.63	\$10.53	\$20.21	87,016

November 17, 1998 - Fiscal 1999

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Dean Morton	11/17/98	\$17.59	\$17.24	\$13.75	\$22.41	7,082

May 26, 1999 - Fiscal 1999

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Richard Wallace	05/26/99	\$22.56	\$22.11	\$21.40	\$29.55	5,417

October 27, 1999 - Fiscal 1999

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Gary Dickerson	10/27/99	\$33.75	\$33.07	\$31.84	\$47.40	100,000
Ken Levy	10/27/99	\$33.75	\$33.07	\$31.84	\$47.40	90,000
John Kispert	10/27/99	\$33.75	\$33.07	\$31.84	\$47.40	30,000
Stuart Nichols	10/27/99	\$33.75	\$33.07	\$31.84	\$47.40	35,000
Ken Schroder	10/27/99	\$33.75	\$33.07	\$31.84	\$47.40	150,000
Richard Wallace	10/27/99	\$33.75	\$33.07	\$31.84	\$47.40	36,250

August 11, 2000 - Fiscal 2001

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Gary E. Dickerson	8/11/2000	\$44.687	\$44.69	\$42.38	\$66.81	41,585

August 13, 2000 - Fiscal 2001

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Kenneth Levy	8/13/2000	\$44.69	\$44.69	\$42.38	\$66.81	37,901
Kenneth L. Schroeder	8/13/2000	\$44.69	\$44.69	\$42.38	\$66.81	75,800
Gary E. Dickerson	8/13/2000	\$44.69	\$44.69	\$42.38	\$66.81	65,000
John H. Kispert	8/13/2000	\$44.69	\$44.69	\$42.38	\$66.81	40,000
Richard P. Wallace	8/13/2000	\$44.69	\$44.69	\$42.38	\$66.81	21,878

August 15, 2000 - Fiscal 2001

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Raymond Bingham	8/15/2000	\$59.44	\$52.75	\$42.38	\$66.81	20,000
Robert Bond	8/15/2000	\$59.44	\$52.75	\$42.38	\$66.81	20,000

November 10, 2000 - Fiscal 2001

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Kenneth Levy	11/10/2000	\$26.25	\$26.25	\$26.25	\$36.81	18,951
Kenneth L. Schroeder	11/10/2000	\$26.25	\$26.25	\$26.25	\$36.81	37,900

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Gary E. Dickerson	11/10/2000	\$26.25	\$26.25	\$26.25	\$36.81	32,500
John H. Kispert	11/10/2000	\$26.25	\$26.25	\$26.25	\$36.81	20,000
Richard P. Wallace	11/10/2000	\$26.25	\$26.25	\$26.25	\$36.81	12,250
Richard J. Elkus	11/10/2000	\$26.25	\$26.25	\$26.25	\$36.81	10,000
Lida Urbanek	11/10/2000	\$26.25	\$26.25	\$26.25	\$36.81	10,000
Edward Barnholt	11/10/2000	\$26.25	\$26.25	\$26.25	\$36.81	10,000
Jon D. Tompkins	11/10/2000	\$26.25	\$26.25	\$26.25	\$36.81	10,000
Dean Morton	11/10/2000	\$26.25	\$26.25	\$26.25	\$36.81	10,000
Stuart Nichols	11/10/2000	\$26.25	\$26.25	\$26.25	\$36.81	6,000

April 4, 2001 - Fiscal 2001

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Kenneth Levy	4/4/2001	\$32.75	\$32.75	\$32.75	\$54.50	18,951
Kenneth L. Schroeder	4/4/2001	\$32.75	\$32.75	\$32.75	\$54.50	37,900
Gary E. Dickerson	4/4/2001	\$32.75	\$32.75	\$32.75	\$54.50	32,500
John H. Kispert	4/4/2001	\$32.75	\$32.75	\$32.75	\$54.50	20,000
Richard P. Wallace	4/4/2001	\$32.75	\$32.75	\$32.75	\$54.50	13,832
Stuart Nichols	4/4/2001	\$32.75	\$32.75	\$32.75	\$54.50	6,000

October 2, 2001 – Fiscal 2002

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Kenneth L. Schroeder	10/2/2001	\$29.31	\$29.31	\$28.86	\$51.46	341,100
Gary E. Dickerson	10/2/2001	\$29.31	\$29.31	\$28.86	\$51.46	105,000
John H. Kispert	10/2/2001	\$29.31	\$29.31	\$28.86	\$51.46	60,000
Richard P. Wallace	10/2/2001	\$29.31	\$29.31	\$28.86	\$51.46	45,000
Kenneth Levy	10/2/2001	\$29.31	\$29.31	\$28.86	\$51.46	28,425
Jeffrey Hall	10/2/2001	\$29.31	\$29.31	\$28.86	\$51.46	22,500
Stuart Nichols	10/2/2001	\$29.31	\$29.31	\$28.86	\$51.46	12,000

November 9, 2001 – Fiscal 2002

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Raymond Bingham	11/9/01	\$47.23	\$47.23	\$34.88	\$56.96	10,000
Robert Bond	11/9/01	\$47.23	\$47.23	\$34.88	\$56.96	10,000

November 8, 2002 – Fiscal 2003

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Kenneth L. Schroeder	11/8/2002	\$37.05	\$37.05	\$28.34	\$45.09	31,450
Gary E. Dickerson	11/8/2002	\$37.05	\$37.05	\$28.34	\$45.09	25,000
John H. Kispert	11/8/2002	\$37.05	\$37.05	\$28.34	\$45.09	12,500
Richard P. Wallace	11/8/2002	\$37.05	\$37.05	\$28.34	\$45.09	12,500
Edward Barnholt	11/8/2002	\$37.05	\$37.05	\$28.34	\$45.09	10,000

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Raymond Bingham	11/8/2002	\$37.05	\$37.05	\$28.34	\$45.09	10,000
Robert T. Bond	11/8/2002	\$37.05	\$37.05	\$28.34	\$45.09	10,000
Richard J. Elkus	11/8/2002	\$37.05	\$37.05	\$28.34	\$45.09	10,000
Stephen Kaufman	11/8/2002	\$37.05	\$37.05	\$28.34	\$45.09	10,000
Lida Urbanek	11/8/2002	\$37.05	\$37.05	\$28.34	\$45.09	10,000
Jon D. Tompkins	11/8/2002	\$37.05	\$37.05	\$28.34	\$45.09	10,000
Jeffrey Hall	11/8/2002	\$37.05	\$37.05	\$28.34	\$45.09	3,250

January 28, 2003 – Fiscal 2003

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Kenneth L. Schroeder	1/28/2003	\$34.67	\$34.67	\$31.15	\$40.77	62,900
Gary E. Dickerson	1/28/2003	\$34.67	\$34.67	\$31.15	\$40.77	50,000
John H. Kispert	1/28/2003	\$34.67	\$34.67	\$31.15	\$40.77	25,000
Richard P. Wallace	1/28/2003	\$34.67	\$34.67	\$31.15	\$40.77	25,000

May 22, 2003 – Fiscal 2003

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Jeffrey Hall	5/22/2003	\$40.14	\$40.14	\$38.34	\$48.60	5,500
Gary E. Dickerson	5/22/2003	\$40.14	\$40.14	\$38.34	\$48.60	1,000
Richard P. Wallace	5/22/2003	\$40.14	\$40.14	\$38.34	\$48.60	1,000

July 30, 2003 – Fiscal 2004

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Kenneth L. Schroeder	7/30/2003	\$51.23	\$51.23	\$46.50	\$58.69	31,450
Gary E. Dickerson	7/30/2003	\$51.23	\$51.23	\$46.50	\$58.69	25,000
John H. Kispert	7/30/2003	\$51.23	\$51.23	\$46.50	\$58.69	12,500
Richard P. Wallace	7/30/2003	\$51.23	\$51.23	\$46.50	\$58.69	12,500
Jeffrey Hall	7/30/2003	\$51.23	\$51.23	\$46.50	\$58.69	3,250

October 27, 2003 – Fiscal 2004

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Kenneth L. Schroeder	10/27/2003	\$53.86	\$53.86	\$51.60	\$60.88	60,000
Gary E. Dickerson	10/27/2003	\$53.86	\$53.86	\$51.60	\$60.88	50,000
John H. Kispert	10/27/2003	\$53.86	\$53.86	\$51.60	\$60.88	30,000
Richard P. Wallace	10/27/2003	\$53.86	\$53.86	\$51.60	\$60.88	30,000
Jeffrey Hall	10/27/2003	\$53.86	\$53.86	\$51.60	\$60.88	5,200

November 5, 2003 – Fiscal 2004

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Stephen P. Kaufman	11/05/03	\$59.44	\$59.44	\$52.29	\$59.65	10,000
Michael Marks	11/05/03	\$59.44	\$59.44	\$52.29	\$59.65	10,000
Raymond Bingham	11/05/03	\$59.44	\$59.44	\$52.29	\$59.65	10,000

January 27, 2004 – Fiscal 2004

Name of Executive/ Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Kenneth L. Schroeder	1/27/2004	\$58.10	\$58.10	\$53.64	\$62.52	30,000
Gary E. Dickerson	1/27/2004	\$58.10	\$58.10	\$53.64	\$62.52	25,000
John H. Kispert	1/27/2004	\$58.10	\$58.10	\$53.64	\$62.52	15,000
Richard P. Wallace	1/27/2004	\$58.10	\$58.10	\$53.64	\$62.52	15,000
Jeffrey Hall	1/27/2004	\$58.10	\$58.10	\$53.64	\$62.52	2,600

April 26, 2004 – Fiscal 2004

Name of Executive/ Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Kenneth L. Schroeder	4/26/2004	\$45.16	\$45.16	\$41.70	\$53.88	37,500
Gary E. Dickerson	4/26/2004	\$45.16	\$45.16	\$41.70	\$53.88	31,250
John H. Kispert	4/26/2004	\$45.16	\$45.16	\$41.70	\$53.88	18,750
Richard P. Wallace	4/26/2004	\$45.16	\$45.16	\$41.70	\$53.88	18,750
Jeffrey Hall	4/26/2004	\$45.16	\$45.16	\$41.70	\$53.88	3,250

August 2, 2004 – Fiscal 2005

Name of Executive/ Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Kenneth L. Schroeder	8/2/2004	\$40.66	\$40.66	\$35.69	\$46.30	22,500
John H. Kispert	8/2/2004	\$40.66	\$40.66	\$35.69	\$46.30	11,250
Richard P. Wallace	8/2/2004	\$40.66	\$40.66	\$35.69	\$46.30	11,250

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Avi Cohen	8/2/2004	\$40.66	\$40.66	\$35.69	\$46.30	6,000
Lance Glasser	8/2/2004	\$40.66	\$40.66	\$35.69	\$46.30	3,750
Jeffrey Hall	8/2/2004	\$40.66	\$40.66	\$35.69	\$46.30	1,950

September 21, 2004 – Fiscal 2005

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Kenneth L. Schroeder	9/21/2004	\$41.79	\$41.79	\$36.60	\$43.67	325,800
John H. Kispert	9/21/2004	\$41.79	\$41.79	\$36.60	\$43.67	75,000
Richard P. Wallace	9/21/2004	\$41.79	\$41.79	\$36.60	\$43.67	75,000
Avi Cohen	9/21/2004	\$41.79	\$41.79	\$36.60	\$43.67	75,000
Lance Glasser	9/21/2004	\$41.79	\$41.79	\$36.60	\$43.67	75,000
Jeffrey Hall	9/21/2004	\$41.79	\$41.79	\$36.60	\$43.67	20,000

October 18, 2004 – Fiscal 2005

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Stephen P. Kaufman	10/18/2004	\$40.68	\$40.68	\$39.49	\$45.70	2,500
Raymond Bingham	10/18/2004	\$40.68	\$40.68	\$39.49	\$45.70	2,500

January 25, 2005 – Fiscal 2005

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Stephen P. Kaufman	1/25/2005	\$44.76	\$44.76	\$42.25	\$50.50	2,500
Raymond Bingham	1/25/2005	\$44.76	\$44.76	\$42.25	\$50.50	5,000

May 11, 2005 - Fiscal 2005

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Stephen P. Kaufman	5/11/05	\$40.24	\$40.24	\$38.86	\$46.87	2,500
Raymond Bingham	5/11/05	\$40.24	\$40.24	\$38.86	\$46.87	2,500

August 2, 2005 - Fiscal 2006

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Stephen P. Kaufman	8/02/2005	\$51.35	\$51.35	\$44.37	\$51.70	2,500
Michael Marks	8/02/2005	\$51.35	\$51.35	\$44.37	\$51.70	2,500
Raymond Bingham	8/02/2005	\$51.35	\$51.35	\$44.37	\$51.70	2,500

November 4, 2005 - Fiscal 2006

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Stephen P. Kaufman	11/04/2005	\$49.99	\$49.99	\$45.52	\$54.09	1,250
Michael Marks	11/04/2005	\$49.99	\$49.99	\$45.52	\$54.09	1,250
Raymond Bingham	11/04/2005	\$49.99	\$49.99	\$45.52	\$54.09	3,750

September 26, 2005 - Fiscal 2006

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Richard P. Wallace	9/26/2005	\$47.95	\$47.95	\$45.17	\$50.71	125,000
John H. Kispert	9/26/2005	\$47.95	\$47.95	\$45.17	\$50.71	75,000
Jeffrey L. Hall	9/26/2005	\$47.95	\$47.95	\$45.17	\$50.71	30,000
Avi Cohen	9/26/2005	\$47.95	\$47.95	\$45.17	\$50.71	75,000
Kenneth Schroeder	9/26/2005	\$47.95	\$47.95	\$45.17	\$50.71	325,800

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Lance Glasser	9/26/2005	\$47.95	\$47.95	\$45.17	\$50.71	75,000

January 31, 2006 – Fiscal 2006

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Stephen P. Kaufman	1/31/06	\$51.98	\$51.98	\$49.33	\$54.18	1,250
Michael Marks	1/31/06	\$51.98	\$51.98	\$49.33	\$54.18	1,250
Raymond Bingham	1/31/06	\$51.98	\$51.98	\$49.33	\$54.18	1,250

February 17, 2006 - Fiscal 2006

Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Richard P. Wallace	2/17/2006	\$52.53	\$52.53	\$48.67	\$54.18	50,000
John H. Kispert	2/17/2006	\$52.53	\$52.53	\$48.67	\$54.18	25,000
Jeffrey L. Hall	2/17/2006	\$52.53	\$52.53	\$48.67	\$54.18	15,000

May 2, 2006 - Fiscal 2006

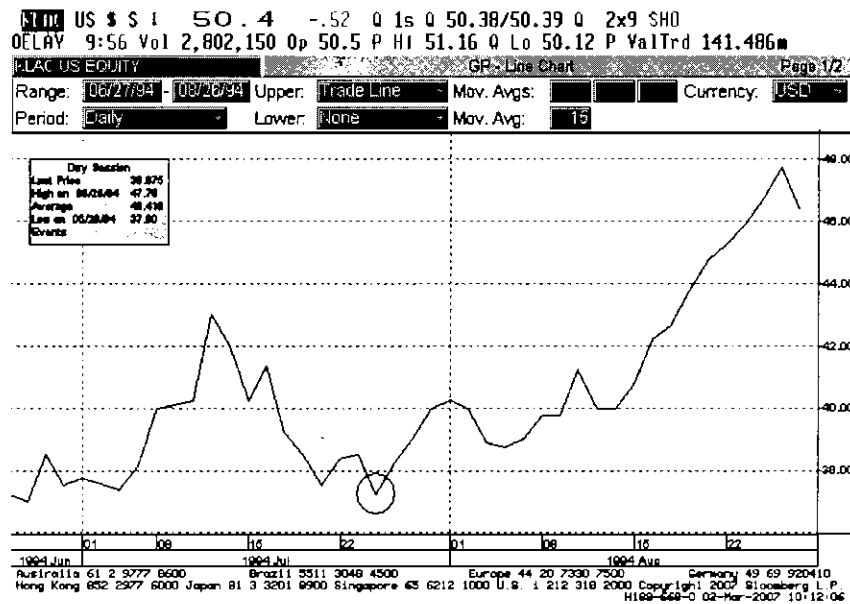
Name of Executive/Director	Grant Date Reported	Strike Price	Closing Price on "Grant" Date	40-Day Low Closing Price	40-Day High Closing Price	Number of Securities Underlying Options
Stephen P. Kaufman	5/02/06	\$47.86	\$47.86	\$39.07	\$50.39	1,250
Raymond Bingham	5/02/06	\$47.86	\$47.86	\$39.07	\$50.39	1,250
Michael Marks	5/02/06	\$47.86	\$47.86	\$39.07	\$50.39	1,250

310. Other options granted to defendants during the Class Period are identified in the charts below showing actual exercises of options and sales of stock.

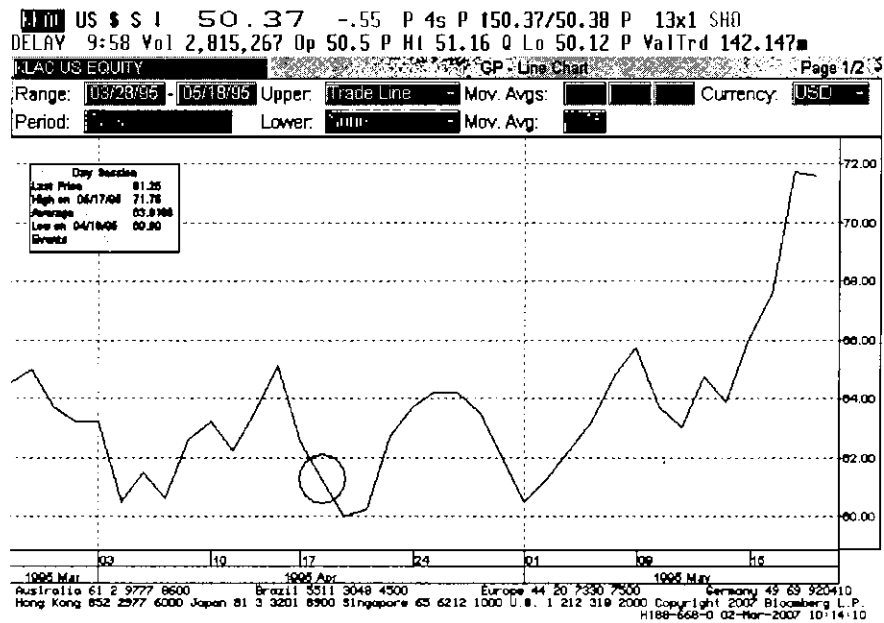
311. While KLA has not identified precisely which options were backdated, it has

confirmed that options granted during this period had been retroactively priced for all employees who received such grants. It has also admitted that Schroeder, Kispert, Nichols, Levy and Wallace all received backdated options. Based on these admissions and the following charts showing how all the alleged grant dates fell suspiciously at or close to low stock prices, there is a strong inference that all of the options granted to all defendants during the Class Period were backdated options:

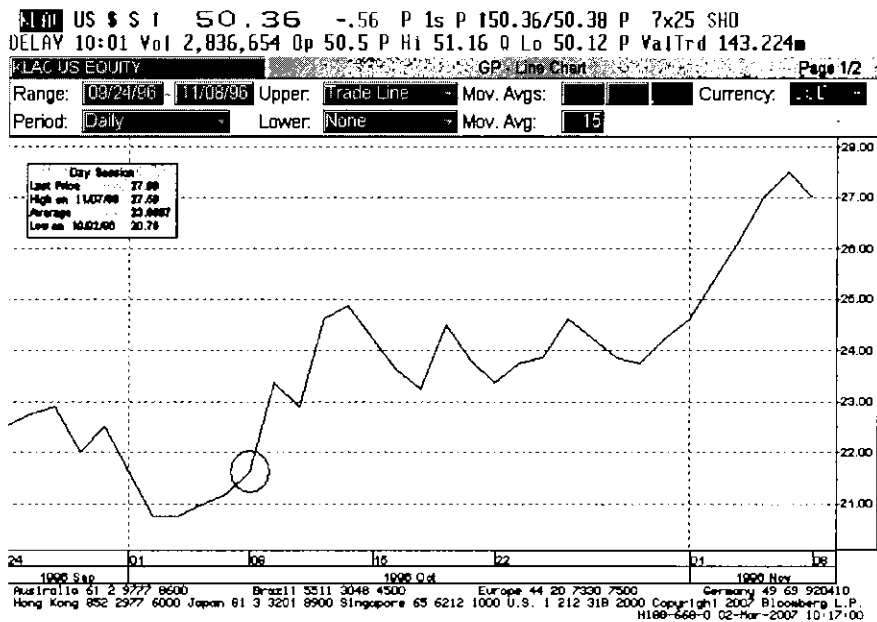
July 26, 1994



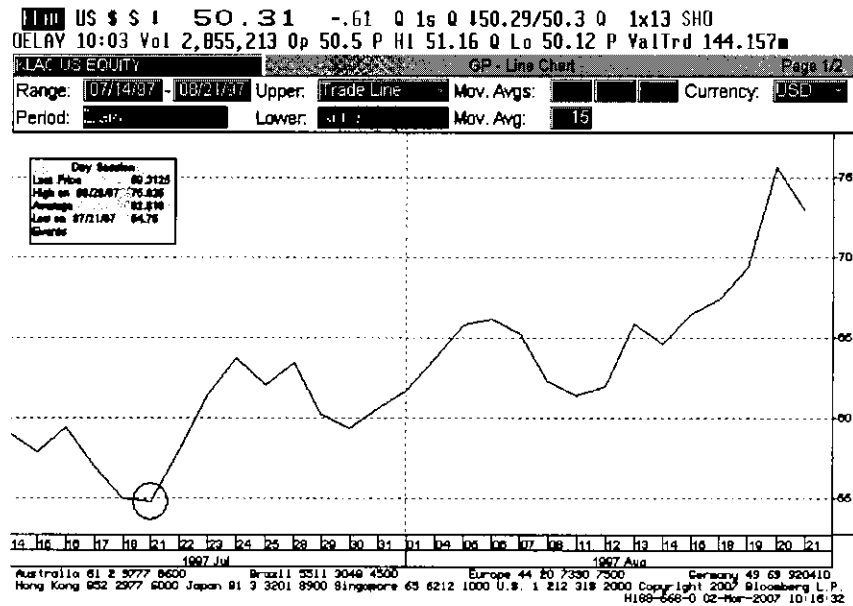
1 April 18, 1995



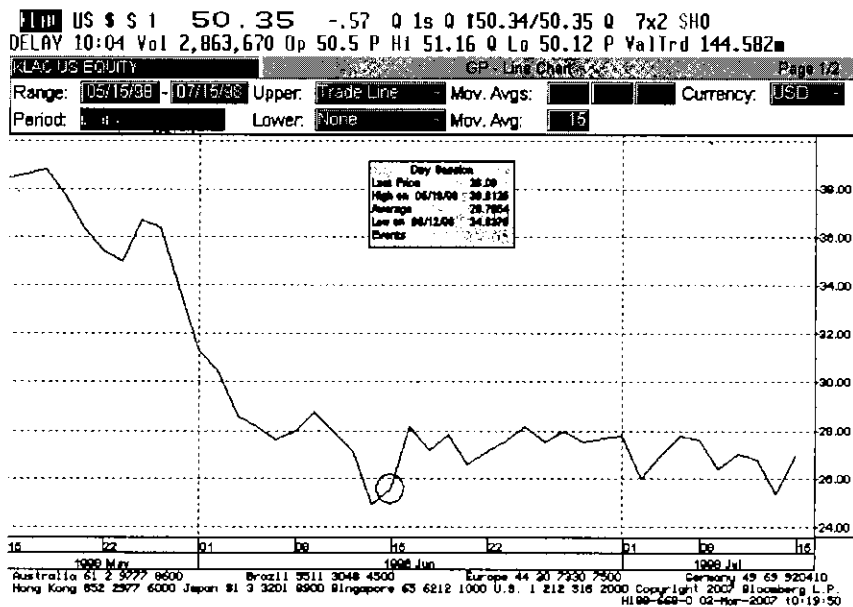
October 8, 1996



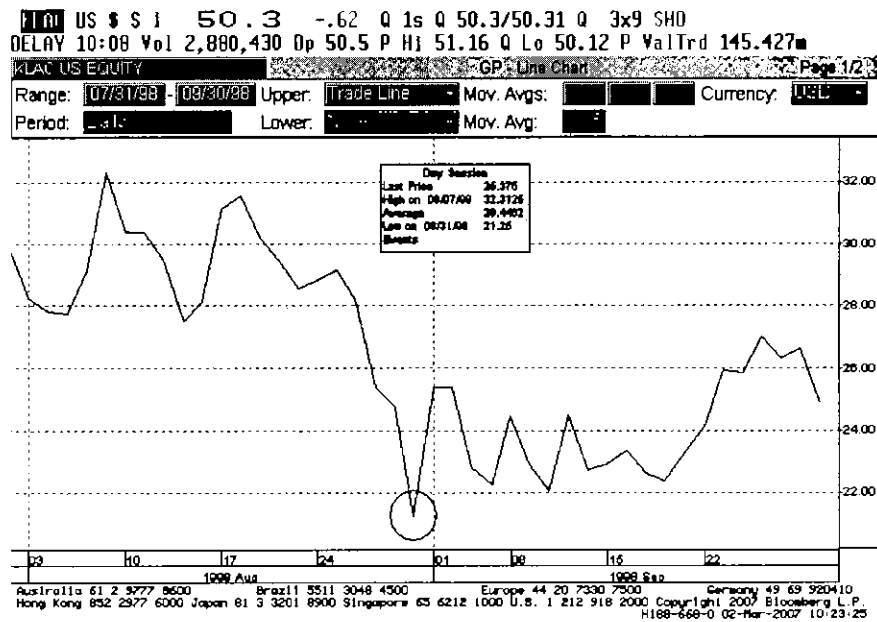
July 21, 1997



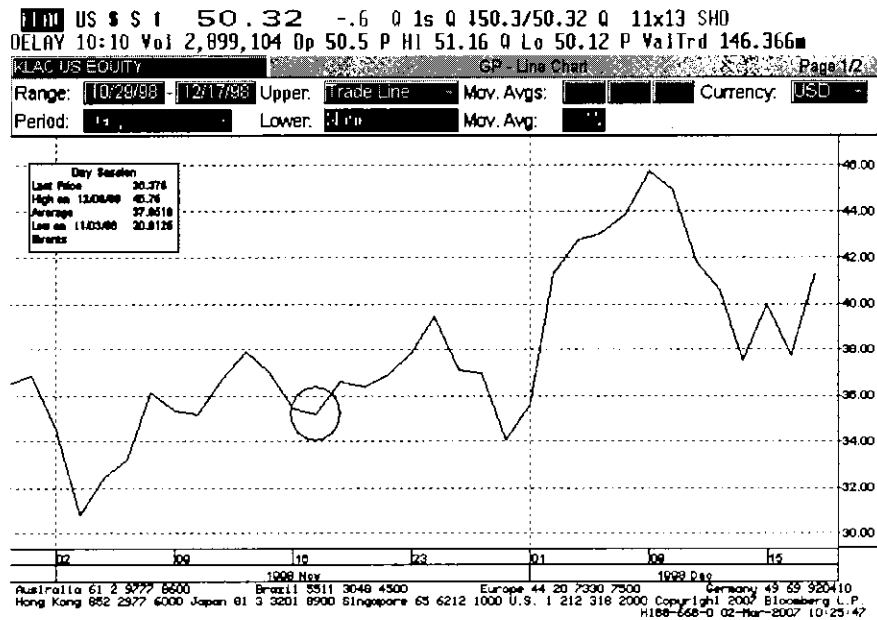
June 15, 1998



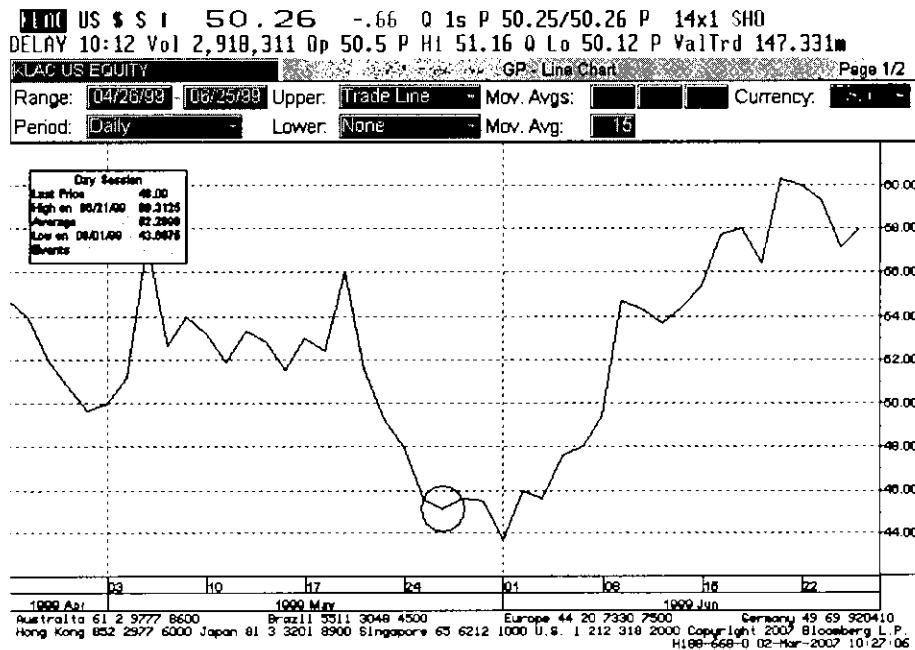
August 31, 1998



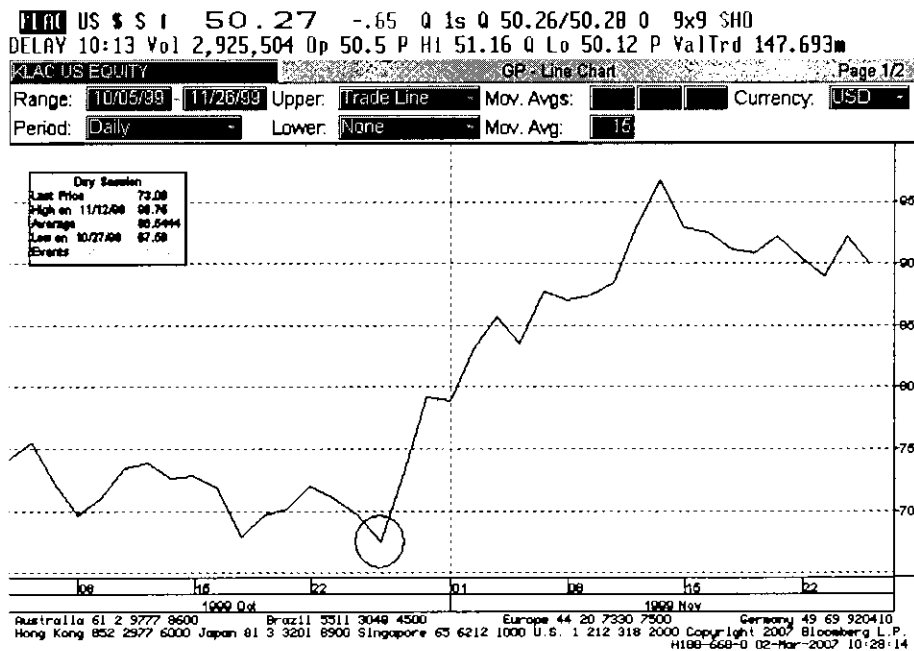
November 17, 1998



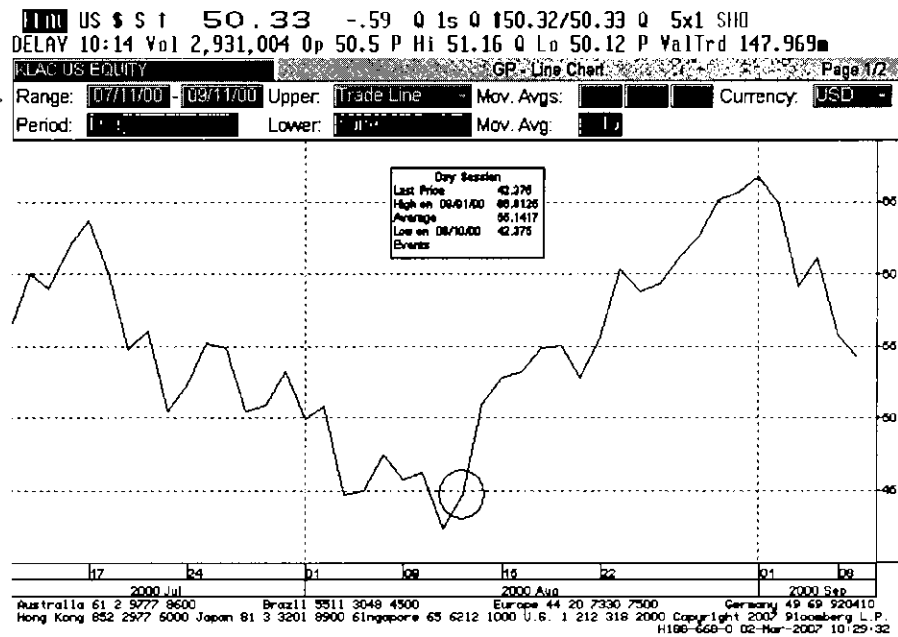
May 26, 1999



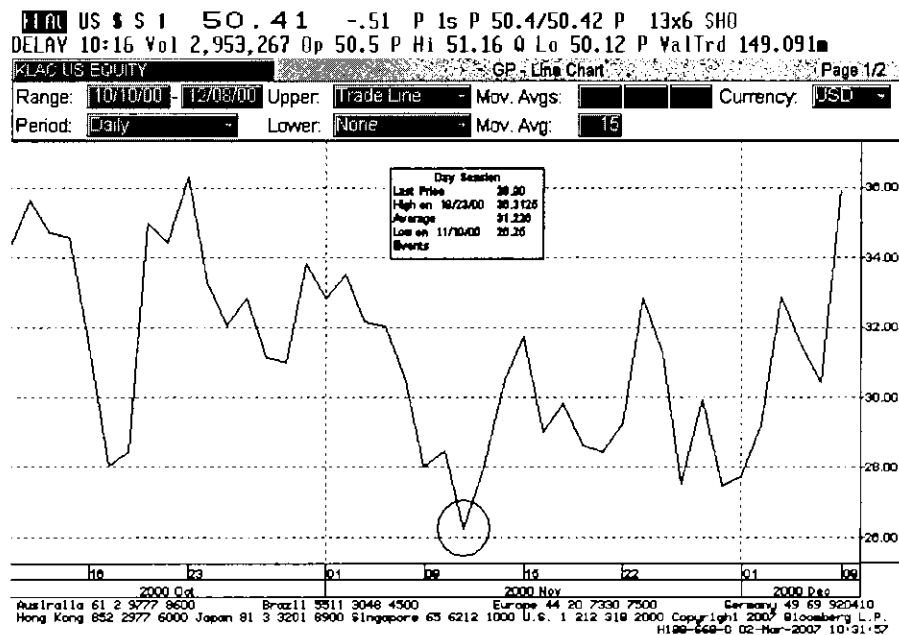
October 27, 1999



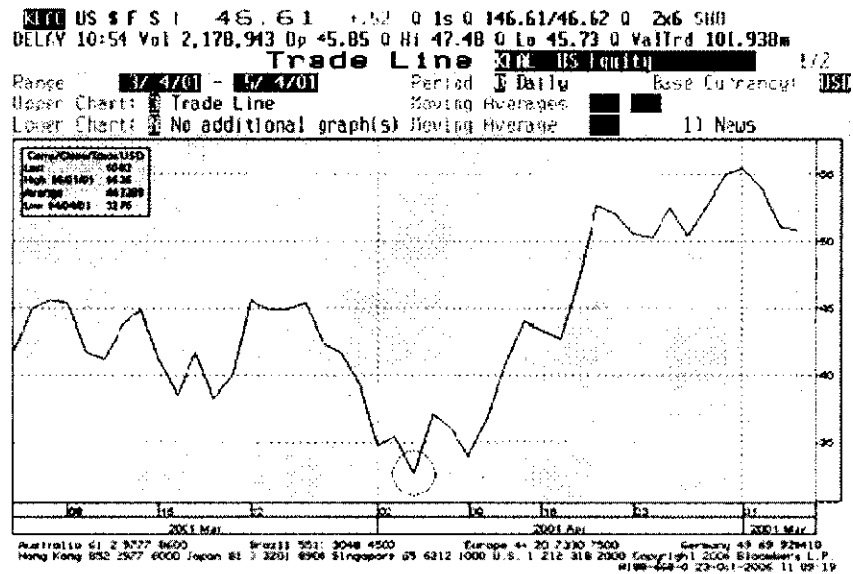
August 11, 2000



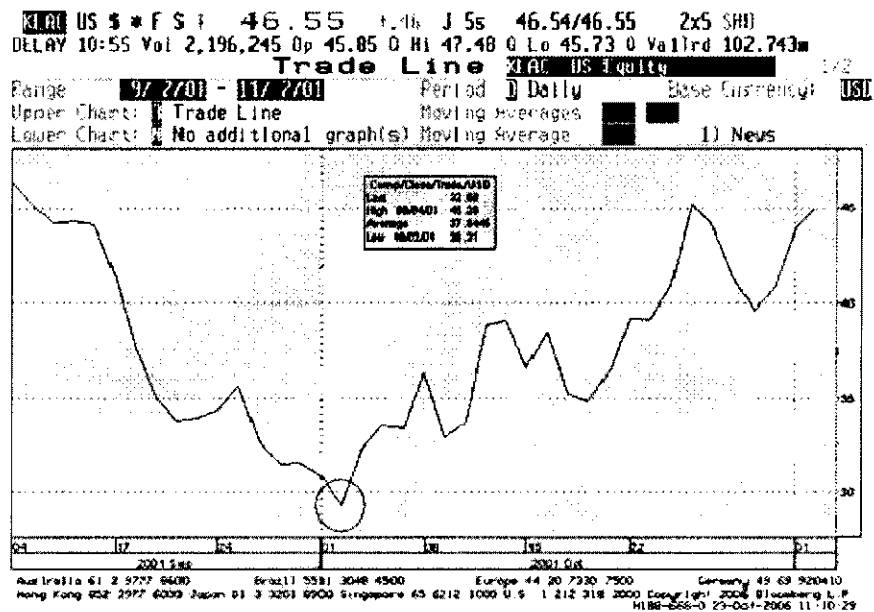
November 10, 2000



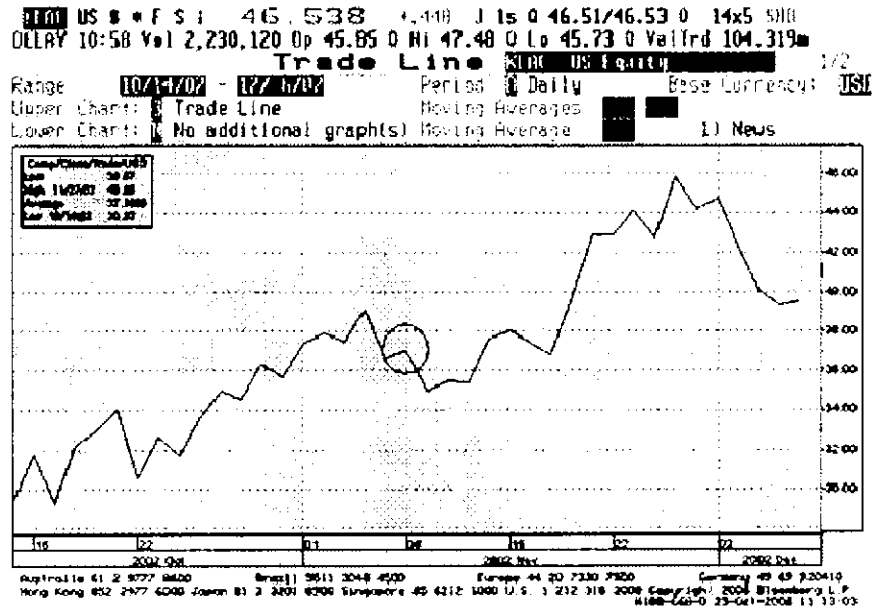
1 April 4, 2001



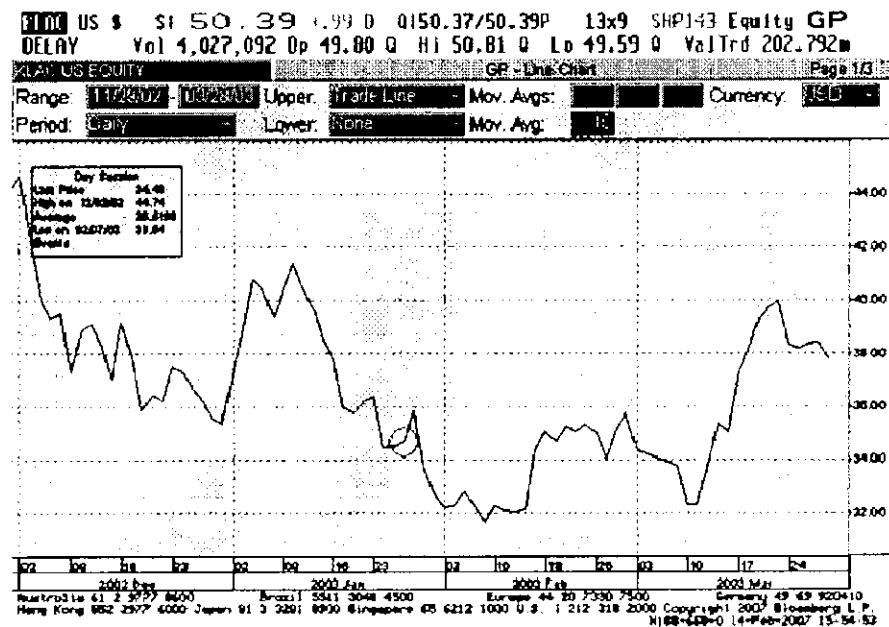
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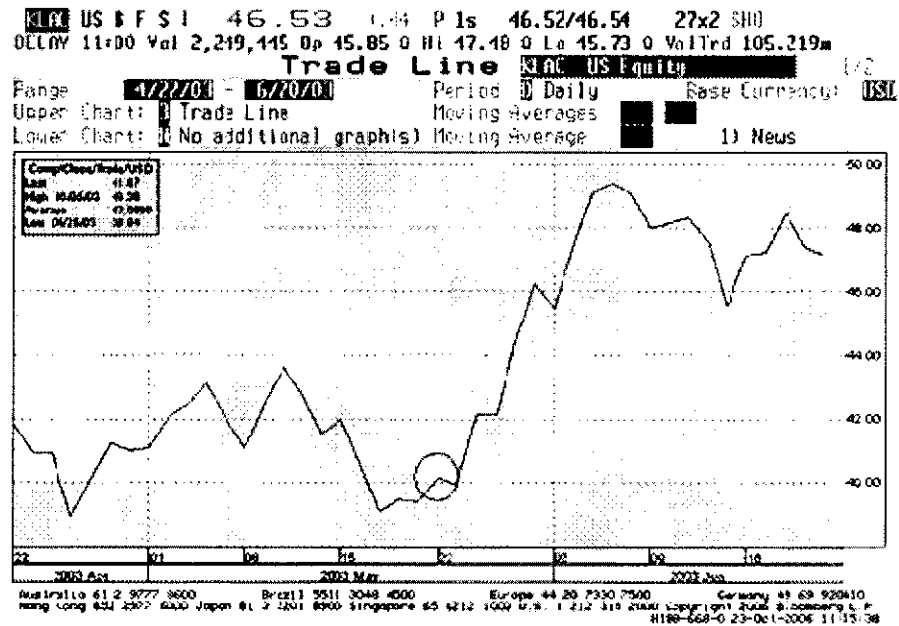
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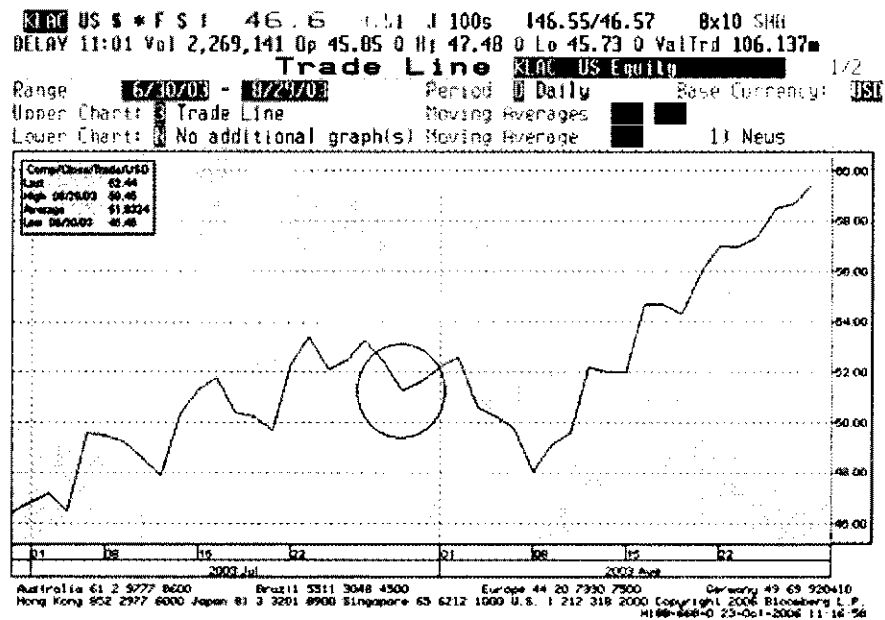
January 28, 2003

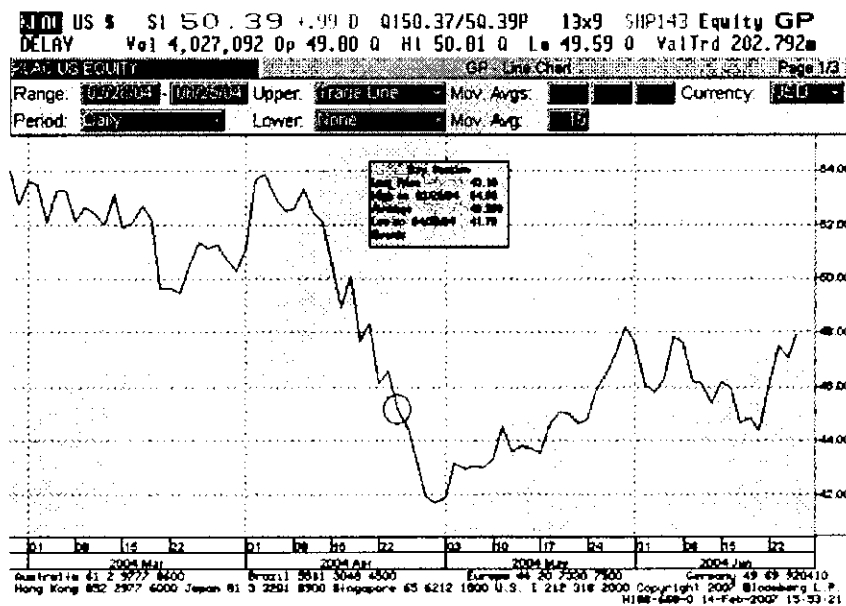


May 22, 2003



July 30, 2003





312. Second, Wallace, Schroeder, Levy, Tompkins, Dickerson, Hall, Kispert, Urbanek, Marks, Barnholt, Bond, Elkus, Morton, Kaufman and Bingham actually exercised backdated options, thereby cashing in on their fraudulent scheme. The following charts set

forth the proceeds realized by each defendant when they exercised their stock option grants:

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized on Transaction
Wallace, Richard P.	10/27/99	12/03/03	\$33.75	5,041	\$59.5382	5,041	\$129,998.32
	08/13/00	12/03/03	\$44.6875	2,709	\$59.5382	2,709	\$40,230.55
	11/10/00	12/03/03	\$26.25	875	\$59.5382	875	\$29,127.18
	04/04/02	12/03/03	\$32.75	875	\$59.5382	875	\$23,439.68
	10/02/01	12/03/03	\$29.31	3,000	\$59.5382	3,000	\$90,684.60
	11/08/02	12/03/03	\$37.05	2,500	\$59.5382	2,500	\$146,382.55
	01/28/03	12/03/03	\$34.67	5,000	\$59.5382	5,000	\$124,341.00
	10/27/99	08/21/03	\$33.75	18,667	\$54.82	18,667	\$393,313.69
	11/10/00	08/21/03	\$26.25	292	\$54.82	292	\$8,342.44
	04/04/01	08/21/03	\$32.75	291	\$54.82	291	\$6,422.37
	10/02/01	08/21/03	\$29.31	750	\$54.82	750	\$19,132.50
	10/27/99	07/31/03	\$33.75	1,292	\$52.6275	1,292	\$24,389.73
	11/10/00	07/31/03	\$26.25	583	\$52.6275	583	\$15,378.086
	04/04/01	07/31/03	\$32.75	4,207	\$52.6275	4,207	\$83,624.64
	10/02/01	07/31/03	\$29.31	13,918	\$52.6275	13,918	\$324,532.97
	08/31/98	06/06/03	\$10.63	1,250	\$50.885	1,250	\$50,318.75
	08/31/98	06/06/03	\$10.63	834	\$50.885	834	\$33,572.67
	08/31/98	06/06/03	\$10.63	2,500	\$50.885	2,500	\$100,637.50
	08/31/98	06/06/03	\$10.63	2,500	\$50.885	2,500	\$100,637.50
	08/31/98	06/06/03	\$10.63	2,167	\$50.885	2,167	\$87,232.59
	05/26/99	06/06/03	\$22.56	5,417	\$50.885	5,417	\$153,436.53
	11/10/00	06/06/03	\$26.25	3,500	\$50.885	3,500	\$86,222.50

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized on Transaction
	10/02/01	06/06/03	\$29.31	1,832	\$50.885	1,832	\$39,525.40
TOTAL							\$2,110,923.71

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
Schroeder, Kenneth		02/08/06	\$16.97	132,658	\$53.9155	132,658	\$4,901,116.14
		02/08/06	????				
	10/23/98	11/30/05	\$16.97	21,136	\$51.7382	21,136	\$734,860.68
	10/23/98	11/30/05	\$16.97	28,864	\$51.7382	28,864	\$1,003,549.33
	10/23/98	11/04/05	\$16.97	50,000	\$49.5026	50,000	\$1,626,630.00
	08/31/98	08/23/05	\$10.63	35,304	\$49.6331	35,304	\$1,376,965.44
	10/23/98	08/23/05	\$16.97	14,696	\$49.6331	14,696	\$488,933.94
	08/31/98	02/28/05	\$10.63	43,968	\$50.4927	43,968	\$1,752,683.19
	10/23/98	12/03/04	\$16.97	47,361	\$49.2846	47,361	\$1,530,451.77
	10/23/98	12/02/04	\$16.97	2,639	\$47.50	2,639	\$80,568.67
	08/31/98	01/28/04	\$10.63	25,000	\$58.5754	25,000	\$1,198,635.00
	08/31/98	01/28/04	\$10.63	25,000	\$58.5754	25,000	\$1,198,635.00
	08/31/98	08/22/03	\$10.63	50,000	\$57.8089	50,000	\$2,358,945.00
	08/31/98	08/19/03	\$10.81	25,000	\$54.4537	25,000	\$1,091,092.50
	10/08/96	08/19/03	\$10.63	25,000	\$54.4537	25,000	\$1,091,092.50
	10/08/96	08/15/03	\$10.81	25,000	\$52.0009	25,000	\$1,029,772.50
	10/08/96	08/14/03	\$10.81	25,000	\$52	25,000	\$1,029,750.00
	10/08/96	08/04/03	\$10.81	25,000	\$52.25	25,000	\$1,036,000.00
	07/26/94	07/31/03	\$9.31	24,100	\$52.753	24,100	\$1,046,976.30
	07/26/94	06/06/03	\$9.31	35,900	\$50.0917	35,900	\$1,464,063.03

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
TOTAL							\$26,040,720.99

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized On Sale
Levy, Kenneth	08/31/98	11/18/05	\$10.63	50,000	\$51.20	50,000	\$2,028,500.00
	10/08/96	08/02/05	\$10.81	75,000	\$51.2675	75,000	\$3,034,312.50
	10/08/96	12/15/04	\$10.81	25,000	\$46.9809	25,000	\$904,272.50
	10/08/96	11/01/04	\$10.81	25,000	\$45.2039	25,000	\$859,874.50
	07/26/94	05/26/04	\$9.31	25,000	\$46.281	25,000	\$924,275.00
	07/26/94	05/20/04	\$9.31	15,000	\$45.1833	15,000	\$538,099.50
	07/26/94	05/19/04	\$9.31	15,000	\$46.2133	15,000	\$553,549.50
	07/26/94	05/18/04	\$9.31	15,000	\$44.8197	15,000	\$532,645.50
	07/26/94	05/13/04	\$9.31	35,000	\$44.00	35,000	\$1,214,150.00
	07/26/94	10/30/03	\$9.31	55,000	\$57.3927	55,000	\$2,644,380.00
	07/26/04	09/16/03	\$9.31	30,000	\$57.0852	30,000	\$1,433,256.00
	07/26/94	08/22/03	\$9.31	50,000	\$57.6186	50,000	\$2,415,430.00
TOTAL							\$17,082,914

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized On Sale
Tompkins, Jon D.	8/31/98	6/7/01	\$10.63	8,000	\$59.22	8,000	\$388,720.00
	8/31/98	6/7/01	\$10.63	12,000	\$59.22	12,000	\$583,080.00
	8/31/98	8/3/01	\$10.63	10,000	\$58.50	10,000	\$478,700.00
	8/31/98	8/3/01	\$10.63	10,000	\$58.50	10,000	\$478,700.00
	8/31/98	8/24/01	\$10.63	2,000	\$50.90	2,000	\$80,540.00
	8/31/98	8/24/01	\$10.63	6,000	\$50.90	6,000	\$241,620.00

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized On Sale
	10/23/98	8/24/01	\$16.97	10,000	\$51.00	10,000	\$340,300.00
	10/23/98	8/27/01	\$16.97	10,000	\$52.00	10,000	\$350,300.00
	10/23/98	11/13/01	\$16.97	20,000	\$50.00	20,000	\$660,600.00
	10/23/98	1/30/02	\$16.97	10,000	\$55.35	10,000	\$383,800.00
	10/23/98	2/4/02	\$16.97	5,000	\$58.10	5,000	\$205,650.00
	10/23/98	2/13/02	\$16.97	10,000	\$60.075	10,000	\$431,050.00
	10/23/08	3/1/02	\$16.97	3,000	\$60.90	3,000	\$131,790.00
	10/23/08	3/7/02	\$16.97	3,000	\$67.0683	3,000	\$150,294.90
	8/31/98	3/8/02	\$10.63	5,000	\$70.00	5,000	\$296,850.00
	8/31/98	5/14/02	\$10.63	5,100	\$60.35	5,100	\$253,572.00
	8/31/98	7/29/02	\$10.63	2,161	N/A	N/A	N/A
	8/31/98	7/29/02	\$10.63	334	N/A	N/A	N/A
	10/23/98	7/29/02	\$16.97	16,016	N/A	N/A	N/A
	11/08/02	08/29/05	\$37.05	5,000	\$49.75	5,000	\$63,500.00
	11/08/02	08/29/05	\$37.05	5,000	\$49.75	5,000	\$63,500.00
	10/18/04	08/29/05	\$40.68	2,500	\$49.75	2,500	\$22,675.00
	05/11/05	08/29/05	\$40.24	2,500	\$49.75	2,500	\$23,775.00
TOTAL							\$5,629,016.90

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
Dickerson, Gary	8/31/98	08/18/03	\$10.63	7,500	\$54.2781	7,500	\$327,360.75
	10/23/98	08/18/03	\$16.97	9,622	\$54.2781	9,622	\$358,978.54
	10/23/98	08/18/03	\$16.97	2,264	\$54.2781	2,264	\$84,465.54
	10/23/98	08/18/03	\$16.97	12,393	\$54.2781	12,393	\$462,359.28

	8/31/98	08/18/03	\$10.63	8,221	\$54.2781	8,221	\$358,831.03
TOTAL							\$1,591,995.14

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
Hall, Jeffrey	10/02/01	11/18/05	\$29.31	4,000	\$51.12	4,000	\$87,240.00
	10/02/01	08/19/05	\$29.31	3,000	\$49.3988	3,000	\$60,266.40
	10/02/01	05/26/05	\$29.31	2,300	\$45.80	2,300	\$37,927.00
	10/02/01	12/03/04	\$29.31	3,000	\$49.6833	3,000	\$61,119.90
TOTAL							\$246,553

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
Kispert, John H.	4/18/95	1/28/02	\$15.31	2,440	\$55.00	2,440	\$96,843.60
	9/17/96	1/28/02	\$10.94	3,000	\$55.00	3,000	\$132,180.00
	10/08/96	1/28/02	\$10.81	2,625	\$55.00	2,625	\$115,998.75
	8/31/98	1/28/02	\$10.63	6,000	\$55.00	6,000	\$266,220.00
	8/31/98	1/28/02	\$10.63	3,500	\$55.00	3,500	\$155,295.00
	8/31/98	1/28/02	\$10.63	7,600	\$55.00	7,600	\$337,212.00
	8/31/98	1/28/02	\$10.63	2,500	\$55.00	2,500	\$110,925.00
	8/31/98	1/28/02	\$10.63	3,000	\$55.00	3,000	\$133,110.00
	08/31/98	09/15/05	\$10.63	1,000	\$50.5089	1,000	\$39,878.90
	08/31/98	09/15/05	\$10.63	299	\$50.5089	299	\$11,923.79
	08/31/98	09/15/05	\$10.63	2,534	\$50.5089	2,534	\$101,053.13
	08/31/98	09/15/05	\$10.63	1,167	\$50.5089	1,167	\$46,538.68
	11/10/00	09/15/05	\$33.75	1,875	\$50.5089	1,875	\$31,422.94
	04/04/01	09/15/05	\$26.25	8,000	\$50.5089	8,000	\$19,4071.20
	04/04/01	09/15/05	\$32.75	8,000	\$50.5089	8,000	\$142,071.20

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
	10/02/01	09/15/05	\$29.31	24,000	\$50.5089	24,000	\$508,773.60
	11/08/02	09/15/05	\$37.05	6,875	\$50.5089	6,875	\$92,529.94
	01/28/03	09/15/05	\$34.67	13,750	\$50.5089	13,750	\$217,784.88
	08/31/98	08/21/03	\$10.63	535	\$56	535	\$24,272.95
	08/31/98	08/21/03	\$10.63	2,000	\$56	2,000	\$90,740.00
	10/27/99	08/21/03	\$33.75	18,790	\$56	18,790	\$418,077.50
	08/11/00	08/21/03	\$44.6875	5,370	\$56	5,370	\$60,748.13
	08/13/00	08/21/03	\$44.6875	25,972	\$56	25,972	\$293,808.25
	11/10/00	08/21/03	\$26.25	11,000	\$56	11,000	\$327,250.00
	04/04/01	08/21/03	\$32.75	9,333	\$56	9,333	\$216,992.25
	10/02/01	08/21/03	\$29.31	22,000	\$56	22,000	\$587,180.00
TOTAL							\$4,752,901.68

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
Urbanek, Lida	05/13/96	02/27/06	\$12.50	280	\$51.931	280	\$11,040.68
	05/13/96	12/14/04	\$12.50	5,000	\$47.1658	5,000	\$173,329.00
TOTAL							\$184,369.68

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
Marks, Michael	05/11/05	05/09/06	\$40.24	2,500	\$48.45	2,500	\$20,525.00
	10/18/04	05/09/06	\$40.68	2,500	\$48.68	2,500	\$20,000.00
	01/25/05	05/09/06	\$44.76	2,500	\$48.83	2,500	\$10,175.00
TOTAL							\$50,700.00

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
Barnholt, Edward	10/25/96	11/18/05	\$10.63	2,500	\$51.04	2,500	\$101,025.00
	10/25/96	11/18/05	\$10.63	2,500	\$51.03	2,500	\$101,000.00
	10/25/96	11/18/05	\$10.63	5,000	\$51	5,000	\$201,850.00
	09/21/98	11/18/05	\$11.66	500	\$51	500	\$19,670.00
	09/21/98	11/18/05	\$11.66	2,500	\$50.96	2,500	\$98,250.00
	09/21/98	11/18/05	\$11.66	2,000	\$50.93	2,000	\$99,528.00
	09/19/97	11/18/05	\$34.94	4,000	\$50.96	4,000	\$64,080.00
	09/20/95	12/10/04	\$23.28	10,000	\$46.3877	10,000	\$231,077.00
TOTAL							\$916,480.00

Name	Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
Bond, Robert T.	11/08/02	09/13/05	\$37.05	5,000	\$50.6136	5,000	\$67,818.00
	11/08/02	09/13/05	\$37.05	5,000	\$50.6136	5,000	\$67,818.00
	08/02/02	11/22/05	\$51.35	2,500	\$52.6097	2,500	\$3,149.25
TOTAL							\$138,785.25

Name	Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
Elkus, Richard	08/02/02	11/22/05	\$51.35	2,500	\$52.6097	2,500	\$3,149.25
	10/18/04	08/09/05	\$40.68	2,500	\$49.36	2,500	\$21,700.00
	05/11/05	08/09/05	\$40.24	2,400	\$49.34	2,400	\$21,840.00
	05/11/05	08/09/05	\$40.24	100	\$49.36	100	\$912.00
	01/25/05	08/09/05	\$44.76	2,500	\$49.36	2,500	\$11,500.00
	11/09/01	12/01/03	\$47.23	5,000	\$59.1123	5,000	\$59,411.50

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Name	Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
	11/09/01	12/01/03	\$47.23	5,000	\$59.1123	5,000	\$59,411.50
	11/08/02	10/29/03	\$37.05	5,000	\$57.385	5,000	\$101,675.00
	11/08/02	10/27/03	\$37.05	5,000	\$53.47	5,000	\$82,100.00
	07/21/97	05/30/03	\$27.38	5,000	\$45.728	5,000	\$91,740.00
	04/30/98	05/15/03	\$20.16	209	\$41.6081	209	\$4,482.65
	11/10/00	05/15/03	\$26.25	2,291	\$41.6081	2,291	\$35,185.41
	11/10/00	05/15/03	\$26.25	5,000	\$41.6081	5,000	\$76,790.50
TOTAL							\$569,897.81

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
Bingham, Raymond	11/08/02	11/22/05	\$37.05	5,000	\$52.6201	5,000	\$77,850.50
	11/08/02	11/22/05	\$37.05	5,000	\$52.6201	5,000	\$77,850.50
TOTAL							\$155,701.00

Name	Reported Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
Morton, Dean	7/21/97	8/26/02	\$27.38	5,000			
	6/15/98	8/26/02	\$12.78	5,000			
	11/17/98	8/26/02	\$17.59	7,082			
	11/10/00	8/26/02	\$26.25	5,000			
	11/10/00	8/26/02	\$26.25	5,000			

Name	Grant Date	Transaction Date	Exercise Price	Number of Shares Acquired on Exercise	Sale price	Number of Shares Sold	Proceeds Realized
Nichols, Stuart	10/27/99	11/13/01	\$33.75	10,000	\$50.0855	10,000	\$163,055.00
	10/27/99	4/22/02	\$33.75	3,000	\$63.8347	3,000	\$90,254.10
	10/27/99	4/30/02	\$33.75	1,000	\$59.3785	1,000	\$25,628.50

TOTAL							\$278,937.60
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313. Third, Barnholt, Bingham, Bond, Dickerson, Elkus, Hall, Kaufman, Kispert, Levy, Schroeder, Tompkins, Urbanek, Wallace and Nichols also sold 1,666,971 shares of stock during the Class Period for proceeds of \$ 59,749,896.76 million. The bulk of the Class Period sales occurred as same day exercises of options and sales of the corresponding share, as set forth in the prior charts. However, there were additional sales as follows:

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Barnholt, Edward W.	11/18/2005	2,500	\$51.0400	\$127,600.00
	11/18/2005	2,500	\$51.0300	\$127,575.00
	11/18/2005	5,000	\$51.0000	\$255,000.00
	11/18/2005	500	\$51.0000	\$25,500.00
	11/18/2005	2,500	\$50.9600	\$127,400.00
	11/18/2005	2,000	\$50.9300	\$101,860.00
	11/18/2005	4,000	\$50.9600	\$203,840.00
	12/10/2004	10,000	\$46.3877	\$463,877.00
TOTAL		29,000		\$1,432,652.00

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Bingham, Raymond	11/22/2005	5,000	\$52.6201	\$263,100.50
	11/22/2005	5,000	\$52.6201	\$263,100.50
TOTAL		10,000		\$526,201.00

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Bond, Robert T.	9/13/2005	5,000	\$50.6136	\$253,068.00
	9/13/2005	5,000	\$50.6136	\$253,068.00
TOTAL		10,000		\$506,136.00

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Dickerson, Gary	8/18/2003	7,500	\$54.2781	\$407,085.75

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
	8/18/2003	9,622	\$54.2551	\$522,042.57
	8/18/2003	2,264	\$54.2638	\$122,853.24
	8/18/2003	12,393	\$54.2926	\$672,848.19
	8/18/2003	8,221	\$54.2553	\$446,032.82
	3/4/2002	1,370	\$64.7100	\$88,652.70
	3/4/2002	2,380	\$64.5895	\$153,723.01
	3/4/2002	1,250	\$64.7000	\$80,875.00
	3/8/2002	2,830	\$69.8400	\$197,647.20
	3/8/2002	727	\$69.8400	\$50,773.68
	2/13/2002	1,370	\$60.5200	\$82,912.40
	2/13/2002	2,380	\$60.4600	\$143,894.80
	2/13/2002	1,250	\$60.5100	\$75,637.50
	1/30/2002	10,960	\$55.0000	\$602,800.00
	1/30/2002	6,540	\$55.0000	\$359,700.00
	1/30/2002	2,500	\$55.0000	\$137,500.00
	1/30/2002	65	\$56.2500	\$3,656.25
	12/5/2001	7,500	\$56.3047	\$422,285.25
	11/13/2001	12,750	\$50.5000	\$643,875.00
TOTAL		93,872		\$5,214,795.37

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Elkus, Richard J., Jr	11/29/2005	5,000	\$51.9591	\$259,795.50
	11/22/2005	2,500	\$52.6097	\$131,524.25
	8/9/2005	2,500	\$49.3600	\$123,400.00
	8/9/2005	2,500	\$49.3600	\$123,400.00
	8/9/2005	2,400	\$49.3400	\$118,416.00
	8/9/2005	100	\$49.3600	\$4,936.00

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
	6/1/2005	5,000	\$45.7222	\$228,611.00
	3/10/2005	5,000	\$48.0800	\$240,400.00
	9/14/2004	10,000	\$40.3312	\$403,312.00
	6/15/2004	5,000	\$45.8954	\$229,477.00
	6/1/2001	5,000	\$47.4600	\$237,300.00
	12/1/2003	5,000	\$59.1123	\$295,561.50
	12/1/2003	5,000	\$59.1123	\$295,561.50
	11/12/2003	10,000	\$59.5100	\$595,100.00
	10/29/2003	5,000	\$57.3850	\$286,925.00
	10/27/2003	5,000	\$53.4700	\$267,350.00
	5/30/2003	5,000	\$45.7280	\$228,640.00
	5/15/2003	209	\$41.6081	\$8,696.09
	5/15/2003	2,291	\$41.6081	\$95,324.16
	5/15/2003	5,000	\$41.6081	\$208,040.50
	3/15/2002	1,709	\$64.5120	\$110,251.01
	3/15/2002	791	\$64.5120	\$51,028.99
	12/6/2001	1,000	\$55.5500	\$55,550.00
TOTAL		96,000		\$4,492,021.51

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Hall, Jeffrey	11/18/2005	4,000	\$51.1200	\$204,480.00
	8/19/2005	3,000	\$49.3988	\$148,196.40
	5/26/2005	2,300	\$45.8000	\$105,340.00
	12/3/2004	3,000	\$49.6833	\$149,049.90
TOTAL		12,300		\$607,066.30

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Kispert, John H.	9/15/2005	1,000	\$50.5089	\$50,508.90
	9/15/2005	229	\$50.5089	\$11,566.54
	9/15/2005	2,534	\$50.5089	\$127,989.55
	9/15/2005	1,167	\$50.5089	\$58,943.89
	9/15/2005	1,875	\$50.5089	\$94,704.19
	9/15/2005	8,000	\$50.5089	\$404,071.20
	9/15/2005	8,000	\$50.5089	\$404,071.20
	9/15/2005	24,000	\$50.5089	\$1,212,213.60
	9/15/2005	6,875	\$50.5089	\$347,248.69
	9/15/2005	13,750	\$50.5089	\$694,497.36
	8/21/2003	535	\$56.0000	\$29,960.00
	8/21/2003	2,000	\$56.0000	\$112,000.00
	8/21/2003	18,790	\$56.0000	\$1,052,240.00
	8/21/2003	5,370	\$56.0000	\$300,720.00
	8/21/2003	25,972	\$56.0000	\$1,454,432.00
	8/21/2003	11,000	\$56.0000	\$616,000.00
	8/21/2003	9,333	\$56.0000	\$522,648.00
	8/21/2003	22,000	\$56.0000	\$1,232,000.00
	1/28/2002	9,335	\$55.0000	\$513,425.00
	1/28/2002	6,000	\$55.0000	\$330,000.00
	1/28/2002	3,500	\$55.0000	\$192,500.00
	1/28/2002	7,600	\$55.0000	\$418,000.00
	1/28/2002	2,500	\$55.0000	\$137,500.00
TOTAL		191,365		\$10,317,240.13

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Levy, Kenneth	11/18/2005	50,000	\$51.2000	\$2,560,000.00
	8/2/2005	75,000	\$51.2675	\$3,845,062.50
	12/15/2004	25,000	\$46.9809	\$1,174,522.50
	11/1/2004	25,000	\$45.2039	\$1,130,097.50
	5/26/2004	25,000	\$46.2810	\$1,157,025.00
	5/20/2004	15,000	\$45.1833	\$677,749.50
	5/19/2004	15,000	\$46.2133	\$693,199.50
	5/18/2004	15,000	\$44.8197	\$672,295.50
	5/13/2004	25,000	\$44.0000	\$1,100,000.00
	10/30/2003	55,000	\$57.3927	\$3,156,598.50
	9/16/2003	30,000	\$57.0852	\$1,712,556.00
	8/22/2003	50,000	\$57.6186	\$2,880,930.00
	1/31/2002	107	\$56.2500	\$6,018.75
TOTAL for Levy		405,107		\$20,766,055.25
KGMW, LP	8/17/2005	40,000	\$49.2586	\$1,970,344.00
	3/1/2005	20,000	\$50.0012	\$1,000,024.00
	6/6/2003	80,000	\$50.6100	\$4,048,800.00
	5/28/2003	100,000	\$43.4308	\$4,343,080.00
	11/22/2002	50,000	\$42.1679	\$2,108,395.00
	2/6/2002	20,000	\$58.8500	\$1,177,000.00
TOTAL for KGMW		310,000		\$14,647,643.00

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Levy Family Trust	9/1/2005	30,000	Gift of shares to Charity	
	8/2/2005	75,000	\$51.2675	\$3,845,062.50
	9/14/2004	25,000	Shares Gifted from Levy Family Trust	
	9/13/2004	25,000	\$40.0542	\$1,001,355.00
	8/20/2003	2,500	Gift of shares on form 5	
	8/22/2003	50,000	\$57.6411	\$2,882,055.00
	8/25/2003	50,000	\$57.6411	\$2,882,055.00
	11/22/2002	25,000	\$42.1679	\$1,054,197.50
	11/22/2002	25,000	\$43.0500	\$1,076,250.00
	2/6/2002	40,000	\$58.4500	\$2,338,000.00
	8/6/2001	20,000	\$58.4200	\$1,168,400.00
TOTAL for Levy Fam. Trust		367,500	\$408.6918	\$16,247,375.00
Levy Family Foundation	N/A	N/A	N/A	N/A
TOTAL		1,082,607		\$63,504,886.00

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Marks, Michael	5/9/2006	2,500	\$48.4500	\$121,125.00
	5/9/2006	2,500	\$48.6800	\$121,700.00
	5/9/2006	2,500	\$48.8300	\$122,075.00
TOTAL		7,500		\$364,900.00

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Nichols, Stuart	4/22/2002	3,000	\$63.8347	\$191,504.10
	4/30/2002	1,700	\$59.3785	\$100,943.45
	4/30/2002	1,000	\$59.3785	\$59,378.50
	11/13/2001	10,000	\$50.0855	\$500,855.00
	11/13/2001	454	\$50.5400	\$22,945.16
TOTAL		16,154		\$875,626.21

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Schroeder, Kenneth L.	2/8/2006	56,032	\$53.9155	\$3,020,993.30
	2/8/2006	30,000	\$53.9155	\$1,617,465.00
	11/30/2005	21,136	\$51.7382	\$1,093,538.60
	11/30/2005	28,864	\$51.7382	\$1,493,371.40
	11/4/2005	50,000	\$49.5026	\$2,475,130.00
	8/23/2005	35,304	\$49.6331	\$1,752,246.96
	8/23/2005	14,696	\$49.6331	\$729,408.04
	2/28/2005	43,968	\$50.4927	\$2,220,063.03
	12/3/2004	47,361	\$49.2846	\$2,334,167.94
	12/2/2004	2,639	\$47.5000	\$125,352.50
	1/28/2004	25,000	\$58.5754	\$1,464,385.00
	1/28/2004	25,000	\$58.5754	\$1,464,385.00
	12/16/2003	50,000	\$55.0800	\$2,754,000.00
	8/22/2003	50,000	\$57.8089	\$2,890,445.00
	8/19/2003	25,000	\$54.4537	\$1,361,342.50
	8/19/2003	25,000	\$54.4537	\$1,361,342.50
	8/15/2003	25,000	\$52.0009	\$1,300,022.50
	8/14/2003	25,000	\$52.0000	\$1,300,000.00

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
	8/4/2003	50,000	\$52.2500	\$2,612,500.00
	7/31/2003	241,000	\$52.7530	\$12,713,473.00
	6/6/2003	35,900	\$50.0917	\$1,798,292.03
	5/14/2002	35,000	\$60.2900 ⁸	\$2,110,150.00
	3/4/2002	900	\$66.7900	\$60,111.00
	3/4/2002	1,000	\$66.7700	\$66,770.00
	3/4/2002	600	\$66.6000	\$39,960.00
	3/4/2002	8,000	\$66.7000	\$533,600.00
	3/4/2002	8,000	\$66.5000	\$532,000.00
	2/13/2002	30,000	\$58.1200	\$1,743,600.00
	2/4/2002	30,000	\$58.9065	\$1,767,195.00
	12/12/2001	30,000	\$55.0200	\$1,650,600.00
	12/11/2001	9,090	\$56.1350	\$510,267.15
	12/6/2001	30,000	\$56.3000	\$1,689,000.00
	12/5/2001	30,000	\$55.0718	\$1,652,154.00
TOTAL		1,119,490		\$60,237,331.45

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Tompkins, Jon	8/29/2005	5,000	\$49.7500	\$248,750.00
	8/29/2005	5,000	\$49.7500	\$248,750.00
	8/29/2005	2,500	\$49.7500	\$124,375.00
	8/29/2005	2,500	\$49.7500	\$124,375.00
	3/12/2004	7,500	\$53.0000	\$397,500.00
	8/27/2003	5,000	\$58.3800	\$291,900.00

⁸ Price not reported on Form 4. Price stated is the closing price on the date of sale.

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
	8/22/2003	5,000	\$57.8000	\$289,000.00
	5/14/2002	5,100	\$60.3500	\$307,785.00
	3/1/2002	3,000	\$60.9000	\$182,700.00
	3/7/2002	3,000	\$67.0683	\$201,204.90
	3/8/2002	5,000	\$70.0000	\$350,000.00
	2/13/2002	10,000	\$60.7500	\$607,500.00
	2/4/2002	5,000	\$58.1000	\$290,500.00
	1/30/2002	10,000	\$55.3500	\$553,500.00
	12/14/2001	1,891	\$51.4000	\$97,197.40
	11/13/2001	20,000	\$50.0000	\$1,000,000.00
	8/3/2001	10,000	\$58.5000	\$585,000.00
	8/3/2001	10,000	\$58.5000	\$585,000.00
	8/3/2001	2,000	\$50.9000	\$101,800.00
	8/3/2001	10,000	\$51.0000	\$510,000.00
	8/3/2001	6,000	\$50.9000	\$305,400.00
TOTAL for Tompkins		133,491		\$7,402,237.30
Trust	2/27/2004	8,819	\$53.0000	\$467,407.00
TOTAL		142,310		\$7,869,644.30

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Urbanek, Lida	2/27/2006	280	\$51.9310	\$14,540.68
	12/14/2004	5,000	\$47.1658	\$235,829.00
TOTAL for Urbanek		5,280		\$250,369.68
Family Foundation	12/12/2003	1,369	\$57.0000	\$78,033.00
	8/6/2003	700	\$50.7100	\$35,497.00
	8/6/2003	300	\$50.6300	\$15,189.00
	5/6/2003	1,000	\$43.1900	\$43,190.00

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
	12/14/2001	500	\$52.0500	\$26,025.00
TOTAL for Foundation		3,869		\$197,934.00
TOTAL		9,149		\$448,303.68

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
Wallace, Richard	12/3/2003	5,041	\$59.5382	\$300,132.07
	12/3/2003	2,709	\$59.5832	\$161,410.89
	12/3/2003	875	\$59.5832	\$52,135.30
	12/3/2003	875	\$59.5832	\$52,135.30
	12/3/2003	3,000	\$59.5832	\$178,749.60
	12/3/2003	2,500	\$59.5832	\$148,958.00
	12/3/2003	5,000	\$59.5832	\$297,916.00
	8/21/2003	18,667	\$54.8200	\$1,023,324.94
	8/21/2003	292	\$54.8200	\$16,007.44
	8/21/2003	291	\$54.8200	\$15,952.62
	8/21/2003	750	\$54.8200	\$41,115.00
	7/31/2003	1,292	\$52.6275	\$67,994.73
	7/31/2003	583	\$52.6275	\$30,681.83
	7/31/2003	4,207	\$52.6275	\$221,403.89
	7/31/2003	13,918	\$52.6275	\$732,469.55
	6/6/2003	1,250	\$50.8850	\$63,606.25
	6/6/2003	834	\$50.8850	\$42,438.09
	6/6/2003	2,500	\$50.8850	\$127,212.50
	6/6/2003	2,500	\$50.8850	\$127,212.50
	6/6/2003	2,167	\$50.8850	\$110,267.80
	6/6/2003	5,417	\$50.8850	\$275,644.05
	6/6/2003	3,500	\$50.8850	\$178,097.50
	6/6/2003	1,832	\$50.8850	\$93,221.32

	Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
1		5/16/2002	24	\$59.8100	\$1,435.44
2		5/16/2002	525	\$59.8400	\$31,416.00
3		5/16/2002	416	\$59.7750	\$24,866.40
4		5/16/2002	84	\$59.7750	\$5,021.10
5		5/16/2002	275	\$59.8400	\$16,456.00
6		3/1/2002	4,766	\$60.8400	\$289,963.44
7		3/1/2002	1,253	\$60.8400	\$76,232.52
8		3/1/2002	1,250	\$60.8400	\$76,050.00
9		3/1/2002	417	\$60.8400	\$25,370.28
10		3/1/2002	542	\$60.8400	\$32,975.28
11		2/13/2002	750	\$61.1000	\$45,825.00
12		2/13/2002	574	\$61.0900	\$35,065.66
13		2/13/2002	719	\$61.0900	\$43,923.71
14		2/13/2002	281	\$61.0900	\$17,166.29
15		2/13/2002	2,000	\$61.1200	\$122,240.00
16		1/31/2002	32	\$56.2500	\$1,800.00
17		12/10/2001	2,000	\$55.0900	\$110,180.00
18		12/10/2001	1,625	\$55.1200	\$89,570.00
19		12/10/2001	1,062	\$55.1200	\$58,537.44
20		12/10/2001	163	\$55.1200	\$8,984.56
21		12/10/2001	100	\$55.1210	\$5,512.10
22		11/27/2001	4,000	\$52.0400	\$208,160.00
23		11/27/2001	145	\$52.0500	\$7,547.25
24		11/27/2001	1,667	\$52.0500	\$86,767.35
25		11/27/2001	1,625	\$52.0500	\$84,581.25
26		11/27/2001	1,875	\$52.0500	\$97,593.75
27		8/7/2001	1,500	\$54.7400	\$82,110.00
28		8/7/2001	324	\$54.6800	\$17,716.32

Name	Transaction Date	Number of Shares sold	Sale price	Profit (Gross)
	8/7/2001	34	\$54.7000	\$1,859.80
	8/7/2001	267	\$54.7600	\$14,620.92
	8/7/2001	416	\$54.7000	\$22,755.20
TOTAL		110,711		\$6,100,390.22

GRAND TOTAL FOR ALL LISTED RECIPIENTS		2,930,458		\$156,454,706.86
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314. Since this fraudulent scheme had commenced by at least 1997, no meaningful comparison of prior trading patterns can be performed. However, the Class Period trades were highly suspicious. In particular, several of the defendants sold shares in May 2006, after some preliminary reports that companies were backdating options and just weeks before the first news that KLA was possibly among the list of companies engaging in such conduct.

315. Defendants clearly had the opportunity to perpetrate the fraudulent scheme described herein by virtue of their positions at the Company and roles in the backdating scheme as alleged herein.

5. The Pervasiveness Of The Fraudulent Conduct And The Nature Of The Accounting Rules At Issue Further Support A Strong Inference Of *Scienter*

316. The duration, magnitude and pervasiveness of the scheme support a strong inference of fraudulent conduct on the part of the Company and the Individual Defendants. KLA admits that the backdating occurred from 1997 forward and that the retroactive pricing of stock options affected all employees who received options. Further, as a result of defendants' improper reporting of backdated options, *the financial results for fiscal years 2002 through 2006 have been restated*. To date, in the Restatement, the Company recorded additional pre-tax, non-cash, stock-based compensation expense of (a) \$348 million for the periods July 1, 1994 to June 30, 2005 under APB No. 25; and (b) \$28 million for the period from July 1, 2005 through December 31, 2006 under SFAS No. 123(R).

1 317. A strong inference of *scienter* is further supported by the nature of the
2 accounting rules at issue. As a preliminary matter, the accounting rules at issue – APB No. 25
3 and SFAS 123(R) – were simple and straightforward in application.

4 318. Moreover, the issue of how to account for officer, director and employee stock
5 option grants was a particularly highly charged and prominent issue for KLA during the Class
6 Period.

7 (a) After more than a decade of debate, FASB considered complete adoption
8 of SFAS 123 in 2004. In March 2004, FASB issued the March 2004 Exposure Draft (“March
9 2004 ED”), *Share-Based Payment*, which amended FAS 123 *Accounting for Stock-Based*
10 *Compensation* and FAS 95 *Statement of Cash Flows*. If adopted, these changes would require
11 compensation costs for options granted to be recognized in financial statements using the fair
12 value at the grant date. After the release of the March 2004 ED, FASB accepted comments on
13 the proposed standard through June 30, 2004. In response, many companies, including KLA,
14 entered the debate to vehemently oppose the proposed changes.

15 (b) KLA was a very active participant in efforts to convince FASB not to
16 change the rule on reporting employee stock option expenses. Indeed, KLA sent letters to
17 FASB during the comment period to voice the Company’s opposition to the proposed rule
18 changes. In one letter, Maureen Lamb, KLA’s Vice President of Finance at the time, not only
19 expressed KLA’s position with regard to the expensing of stock options but also misrepresented
20 the Company’s practices regarding option grants:

21 Maureen Lamb, then a vice president, finance, wrote that while there were flaws
22 in the accounting rules for stock-based compensation, “the politically charged
23 belief that the blame lies with executives unwilling to give up their ill-begotten
compensation is backward and unproductive.”

24 Ms. Lamb, who is no longer with the company, added that “*KLA-Tencor does*
25 *not currently have the ability to issue any equity-based compensation other than*
26 *at-the-money stock options*”⁹

27 ⁹ “FASB Appears In a New Light On Stock Options: Some Companies That Opposed
28 Expensing Rule Are Caught Up In U.S. Probe on ‘Backdating,’” by David Reilly, *The Wall*
Street Journal, August 14, 2006.

1 (Emphasis added.)

2 (c) In its public filings, the Company specifically acknowledged the
3 importance of the accounting rules relating to option grants. For example, in its 2005 Form 10-
4 K, the Company represented that the “adoption of SFAS No. 123(R) which would require us to
5 measure all employee stock-based compensation awards using a fair value method beginning in
6 fiscal year 2006 and record such expense in our consolidated financial statements will have a
7 material impact on our consolidated financial statements as reported under generally accepted
8 accounting principles in the United States.” It also states that it will have a “material impact on
9 the Company’s consolidated results of operations, financial position and statement of cash
10 flows.”

11 319. Significantly, defendants’ knowledge and intent with respect to backdating of
12 stock options is further supported by the fact that such conduct occurred at other companies
13 with which they were involved:

14 (a) Levy is currently on the Board of Directors of Juniper Networks, Inc.
15 According to Juniper Networks’ 2006 Proxy Statement, filed on April 10, 2006, Levy has
16 served as a member of the Board of Directors since 2003. He is a member of Juniper Networks’
17 Compensation Committee and Nominating and Governance Committee. The DOJ has launched
18 an investigation into Juniper’s option grants. Moreover, Juniper has admitted that “there were
19 numerous instances in which grant dates were chosen with the benefit of hindsight as to the
20 price of the company’s stock, so as to give favorable prices,” that prior financial results need to
21 be restated and that it anticipates recording additional non-cash stock-based compensation
22 expense of approximately \$900 million.

23 (b) Levy is also currently on the Board of Directors of Extreme Networks,
24 Inc. According to Extreme Networks’ 2005 Proxy Statement, Levy has served as a director on
25 the Board of Directors since October 2001. He has served on Extreme Network’s Audit
26 Committee, Compensation Committee and Nominating and Corporate Governance Committee.
27 The DOJ has launched an investigation into Extreme Network’s option grants. Moreover,
28

1 Extreme Networks has admitted that it would take charges on option restatements, therefore, its
2 financial reports relating to fiscal periods 2000 through 2005 and the first, second and third
3 quarters of 2006 should no longer be relied upon. Extreme Network's special committee had
4 "reached a preliminary conclusion that the appropriate measurement dates for financial
5 accounting purposes of certain stock option grants differ from the recorded grant dates of those
6 awards" and "additional non-cash charges for stock-based compensation expense will be
7 required that will be material with respect to certain fiscal periods."

8 (c) Barnholt is currently on the Board of Directors of Adobe Systems Inc.
9 According to Adobe Systems' 2006 Proxy Statement, filed on February 24, 2006, Barnholt has
10 served as a director on the Board of Directors since 2005. Adobe has announced "certain
11 instances relating to grants made to employees where the list of employees and/or shares
12 allocated to them was not sufficiently definitive for the grant to be deemed final as of the
13 reported grant date" and that "adjustments were made to some employees grants after the grant
14 date without a corresponding change to the measurement date." On January 4, 2007, Adobe
15 announced that it "has recently determined that certain stock options were granted, for
16 accounting purposes, with an exercise price that is less than the fair market value of the Adobe
17 common stock subject to such options on the applicable 'measurement date.'"

18 (d) Morton is currently on the Board of Directors of BEA Systems
19 Incorporated. According to BEA System's 2006 Proxy Statement, Morton has served as a
20 director of the BEA Systems since March 1996. He has served on BEA Systems' Audit
21 Committee and Nominating and Governance Committee. Morton has also served as Chair of
22 the Audit Committee of the company. In December 2006, BEA Systems admitted in a Form 8-
23 K filed with the SEC that the actual measurement dates for certain stock options differed from
24 the recorded measurement dates for those options and that "the difference in these measurement
25 dates will result in material non-cash, stock-based compensation expenses." On February 14,
26 2007, BEA Systems filed a Form 8-K with the SEC announcing that it "expects that it will
27 restate its financial statements from Fiscal 1998 through its first quarter of fiscal 2007 and that
28

1 it will record non-cash compensation expense, on a pre-tax basis, of between \$340 and \$390
2 million.”

3 (e) Morton served on the Board of Directors of The Clorox Company.
4 Morton served as a director of that company from at least fiscal year 1997 to 2002. He served
5 on The Clorox Company’s Executive Committee, Finance Committee, Compensation
6 Committee and Board Administration and Public Policy Committee. Morton also served as the
7 Chair of the Compensation Committee for the company. On August 2, 2006, The Clorox
8 Company announced in a press release that it would take a \$25 million pre-tax charge for stock-
9 based compensation expense for the fourth quarter ended June 30, 2006, following a review of
10 its historical stock option granting practices.

11 **E. LOSS CAUSATION**

12 320. Defendants’ scheme operated as a fraud or deceit on Lead Plaintiffs and the
13 members of the Class because the false and misleading statements artificially inflated KLA’s
14 securities prices. Indeed, the false and misleading representations concerning KLA’s financial
15 results and management compensation – plus the non-disclosures of material facts concerning
16 the Company’s violation of Company and SEC policies and accounting regulations regarding
17 compensation expenses – caused and maintained the artificial inflation in KLA securities prices
18 throughout the Class Period and until the truth was slowly revealed to the market.

19 321. When defendants’ prior misrepresentations and fraudulent conduct began to be
20 disclosed and started to become apparent to the market, KLA’s stock declined as the prior
21 artificial inflation came out of KLA’s securities prices.

22 322. These disclosures and public revelations about the stock option abuses at KLA
23 did not come to light all at once but came from a variety of sources over a period of time. For
24 example, *The Wall Street Journal* published a front-page article in May 2006 exposing
25 fortuitously timed stock option grants to former KLA executives Levy and Schroeder.

26 323. As investors and the market became aware of the true facts, which had been
27 concealed by defendants, the prior artificial inflation came out of KLA’s securities prices.

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1 From the very first announcement of potential backdating on May 22, 2006, the market has
2 reacted to the news and the stock price has fallen as the prior artificial inflation was slowly
3 removed from the value of KLA's securities. *Significantly, the stock lost approximately \$935*
4 *million in market capitalization* when KLA's common stock price plummeted from a closing
5 price of \$45.24 per share on May 19, 2006 to a closing price of \$40.54 *after the May 22, 2006*
6 *announcement on heavy volume of 13,615,220 shares traded - which was three times the*
7 *average trading volume for the prior three months.* These stock drops caused real economic
8 loss to investors who had purchased the securities during the Class Period.

9 324. The totality of the circumstances around KLA's stock price drops combine to
10 negate any inference that the economic loss suffered by Lead Plaintiffs and the other members
11 of the Class was caused by changed market conditions, macroeconomic or industry factors or
12 KLA-specific facts unrelated to defendants' fraudulent conduct. While there was some post-
13 Class Period rebound of KLA's stock price, these price increases were attributable to
14 defendants' statements downplaying the fraud, new market conditions, macroeconomic or other
15 factors and Company-specific facts unrelated to the fraudulent conduct alleged herein.

16 325. As a result of their purchases of KLA securities during the Class Period, Lead
17 Plaintiffs and other members of the Class suffered economic loss, *i.e.*, damages, under the
18 federal securities laws. The economic loss was a direct result of the fraudulent scheme to
19 artificially inflate KLA's securities prices and the subsequent significant decline in the value of
20 KLA's securities when the truth was revealed.

21 326. The resulting decline in KLA's stock price was foreseeable at the time of
22 defendants' misrepresentations. Indeed, despite being aware of the consequences of their
23 fraudulent conduct, defendants nevertheless knowingly backdated options and engaged in the
24 other alleged misconduct, which, when the truth emerged, caused the stock price to decline.

25 327. KLA's stock had been negatively affected by the growing stock option
26 backdating controversy. The declines in KLA's stock price at the end of the Class Period was a
27 direct result of defendants' fraudulent conduct alleged herein finally being revealed to KLA's
28

1 investors and the market. A company's ultimate destiny is dependent on the integrity of
2 management. In this particular case, the backdating of stock option grants to increase the
3 profitability of the options is a classic example of loss of confidence on the part of investors
4 since management is effectively taking from the Company in order to line their own pockets.

5 **F. PRESUMPTION OF RELIANCE**

6 328. At all relevant times, the market for KLA's publicly traded securities was an
7 efficient market for the following reasons, among others:

8 (a) The Company's common stock met the requirements for public listing
9 and was listed and actively traded on the NASDAQ, a highly efficient market.

10 (b) As a regulated issuer, the Company filed reports with the SEC.

11 (c) The Company regularly issued press releases, which were carried by
12 national news wires. Each of these releases was publicly available and entered the public
13 marketplace.

14 (d) The Company's stock was followed by numerous analysts.

15 329. As a result, the market for the Company's publicly traded securities promptly
16 digested current information with respect to KLA from all publicly available sources and
17 reflected such information in the price of the Company's securities. Under these circumstances,
18 all purchasers of the Company's publicly traded securities during the Class Period suffered
19 similar injury through their purchase of KLA's publicly traded securities at artificially inflated
20 prices and a presumption of reliance applies.

21 **G. NO SAFE HARBOR**

22 330. The statutory safe harbor provided for forward-looking statements under certain
23 circumstances does not apply to any of the allegedly false statements pleaded in this Complaint.
24 None of the specific statements alleged herein are forward looking. Many of the specific
25 statements alleged herein were not identified as "forward-looking statements" when made. To
26 the extent there were any forward-looking statements, there were no meaningful cautionary
27 statements identifying important factors that could cause actual results to differ materially from
28

1 those in the purportedly forward-looking statements. Alternatively, to the extent that the
2 statutory safe harbor does apply to any forward-looking statement, these statements are
3 actionable because, at the time any forward-looking statement was made, the particular speaker
4 knew that the particular forward-looking statement was false and/or the forward-looking
5 statement was authorized and/or approved by an executive officer of KLA who knew that those
6 statements were false when made.

7 **Claims For Relief**

8 **COUNT I**

9 **(Violations of Section 10(b) of the Exchange Act and Rule 10b-5 Promulgated**
10 **Thereunder Against All Defendants)**

11 331. Lead Plaintiffs repeat and restate each and every allegation contained in the
12 foregoing paragraphs as if fully set forth herein.

13 332. The defendants named in this count include KLA, Wallace, Schroeder, Levy,
14 Dickerson, Kispert, Hall, Urbanek, Marks, Barnholt, Bond, Bingham, Elkus, Kaufman, Morton,
15 Tompkins, Nichols and Boehlke.

16 333. During the Class Period, defendants carried out a plan, scheme and course of
17 conduct which was intended to and, throughout the Class Period, did: (a) deceive the investing
18 public, including Lead Plaintiffs and the other members of the Class, as alleged herein; (b)
19 artificially inflate the market price of KLA's securities; and (c) cause Lead Plaintiffs and the
20 other members of the Class to purchase KLA's securities at artificially inflated prices.

21 334. In furtherance of this unlawful scheme, plan and course of conduct, defendants,
22 individually and jointly, took the actions set forth herein. Indeed, defendants: (a) employed
23 devices, schemes and artifices to defraud; (b) made untrue statements of material fact and/or
24 omitted to state material facts necessary to make the statements made not misleading; and (c)
25 engaged in acts, practices and a course of conduct which operated as a fraud and deceit upon the
26 purchasers of the Company's securities in an effort to create and maintain artificially high
27 market prices for KLA's securities in violation of Section 10(b) of the Exchange Act and Rule
28

1 10b-5 promulgated thereunder. Each of the defendants was a direct, necessary and substantial
2 participant in the common course of conduct alleged herein.

3 335. In addition to the duties of full disclosure imposed on defendants as a result of
4 their making affirmative statements and reports to the investing public, defendants had a duty to
5 promptly disseminate truthful information that would be material to investors in compliance
6 with the integrated disclosure provisions of the SEC as embodied in SEC Regulation S-X (17
7 C.F.R. §210.1-01, *et seq.*) and Regulation S-K (17 C.F.R. §229.10, *et seq.*) and other SEC
8 regulations, including accurate and truthful information with respect to the Company's financial
9 condition, earnings and expenses, officer and director compensation and management integrity
10 so that the market price of the Company's securities would be based on truthful, complete and
11 accurate information.

12 336. Defendants, directly and indirectly, by the use, means or instrumentalities of
13 interstate commerce and/or of the mails, engaged and participated in a continuous course of
14 conduct to misrepresent and to not disclose adverse material information about KLA's financial
15 condition, stock option grants, officer and director compensation and management integrity as
16 detailed herein.

17 337. Defendants employed devices, schemes and artifices to defraud while in
18 possession of material adverse non-public information and engaged in acts, practices and a
19 course of conduct as alleged herein in an effort to deceive and/or mislead concerning KLA's
20 stock options, officer and director compensation, financial condition and management integrity.
21 Said schemes, devices, acts and artifices included: (a) the making of or participation in the
22 making of untrue statements; (b) the omitting of material facts necessary in order to make the
23 statements made, in light of the circumstances under which they were made, not misleading;
24 and (c) engaging in transactions, practices and a course of conduct which operated as a fraud
25 and deceit upon the purchasers of KLA's securities during the Class Period. For example,
26 defendants (a) concealed the fact that defendants were allowing insiders to manipulate the
27 Company's stock option plans; (b) obtained and/or allowed KLA officers and directors to obtain
28

1 options using improper exercise prices in violation of its own policies and failed to properly
2 expense compensation derived therefrom; (c) engaged in insider trading and/or allowed KLA
3 officers and directors to trade securities based on material non-public information, which
4 trading was contemporaneous with purchases by members of the Class; and (d) allowed
5 themselves and others to retain executive and directorial positions at KLA and the profits,
6 power and prestige, which defendants enjoyed as a result of these positions.

7 338. Defendants' material misrepresentations, omissions and acts in furtherance of the
8 fraud were done knowingly or with deliberate recklessness and for the purpose and effect of
9 misrepresenting KLA's financial condition, stock option grants, officer and director
10 compensation and management integrity to the investing public and thereby artificially inflating
11 the price of KLA's securities.

12 339. As a result of the above alleged fraudulent scheme and dissemination of the
13 materially false and misleading information regarding KLA's financial results, officer and
14 director compensation and management integrity, the market price of KLA's securities was
15 artificially inflated prior to and during the Class Period. In ignorance of the fact that market
16 prices of KLA's publicly traded securities were artificially inflated and relying, directly or
17 indirectly, on the false and misleading statements made by defendants or upon the integrity of
18 the market in which the securities traded and/or on the absence of material adverse information,
19 Lead Plaintiffs and the other members of the Class acquired KLA securities during the Class
20 Period at artificially high prices and were damaged thereby.

21 340. By virtue of the foregoing, defendants have violated Section 10(b) of the
22 Exchange Act and Rule 10b-5 promulgated thereunder.

23 341. At the time of said misrepresentations and omissions, Lead Plaintiffs and the
24 other members of the Class were ignorant of their falsity and believed them to be true. Had
25 Lead Plaintiffs and the other members of the Class and the marketplace known of the true
26 financial condition of the Company and of its stock option fraud, officer and director
27 compensation and management integrity issues, Lead Plaintiffs and the other members of the
28

1 Class would not have purchased or otherwise acquired the KLA securities or, if they had
2 purchased and/or otherwise acquired such securities during the Class Period, they would not
3 have done so at the artificially inflated prices that they paid.

4 342. As the truth about the extent and severity of KLA's stock option abuses, false
5 and misleading financials and harm to its reputation and credibility in the market started to be
6 released and become apparent to the market, KLA's common stock price plummeted as the
7 prior artificial inflation came out of the Company's stock price. This price decline occurred as
8 the markets continued to digest the impact and meaning of defendants' stock option and other
9 schemes and its impact on KLA. All or a significant portion of the decrease in KLA's stock
10 price was due to the disclosure, revelation and/or leakage of information inconsistent with
11 defendants' prior financial disclosures and other Company filings and releases. This drop
12 removed the inflation from KLA's stock price, causing real economic loss and damage to
13 investors who had purchased the stock during the Class Period.

14 343. As a direct and proximate result of defendants' wrongful conduct, Lead Plaintiffs
15 and the other members of the Class suffered damages in connection with their respective
16 purchases and sales of the Company's securities during the Class Period.

17 **COUNT II**

18 **(Violations of Section 20(a) of the Exchange Act Against The Individual**
19 **Defendants)**

20 344. Lead Plaintiffs repeat and restate each and every allegation contained in the
21 foregoing paragraphs as if fully set forth herein.

22 345. The defendants named in this count, including Wallace, Schroeder, Levy,
23 Dickerson, Hall, Kispert, Urbanek, Marks, Barnholt, Bond, Bingham, Elkus, Kaufman, Morton,
24 Tompkins, Nichols and Boehlke, acted as controlling persons of KLA within the meaning of
25 §20(a) of the Exchange Act. By reason of their high-level positions with the Company, their
26 ownership of KLA stock, their participation in and/or awareness of the Company's operations
27 and/or intimate knowledge of the fraudulent scheme, the false financial statements and
28

1 misrepresentations regarding stock options and executive compensation filed with the SEC and
2 disseminated to the investing public and their participation in the fraudulent acts and/or
3 awareness of such acts, these defendants had the power and authority to control and cause KLA
4 and its employees to engage in the wrongful conduct complained of herein. By reason of such
5 conduct, the defendants named herein are liable pursuant to §20(a) of the Exchange Act.

6 346. As set forth above, KLA and the Individual Defendants each violated Section
7 10(b) and Rule 10b-5 by their acts and omissions as alleged in this Complaint. By virtue of
8 their positions as controlling persons, the Individual Defendants are liable pursuant to Section
9 20(a) of the Exchange Act.

10 347. As a direct and proximate result of the Individual Defendants' wrongful conduct,
11 Lead Plaintiffs and the other members of the Class suffered damages in connection with their
12 purchases of the Company's securities during the Class Period, upon disclosure of the truth.

13 COUNT III

14 (Negligent Violations of Section 14(a) of the Exchange Act and Rule 14a-9 Promulgated 15 Thereunder Against All Defendants)

16 348. Lead Plaintiffs repeat and restate each and every allegation contained in the
17 foregoing paragraphs as if fully set forth herein, except allegations of fraud or intent which are
18 not necessary to assert this Claim. For purposes of this Claim only, Lead Plaintiffs assert
19 negligence claims and expressly disclaim any claim of fraud or intentional misconduct.

20 349. Section 14(a) of the Exchange Act, 15 U.S.C. §78n(a), provides that "[i]t shall be
21 unlawful for any person, by the use of the mails or by any means of instrumentality of interstate
22 commerce or of any facility of a national securities exchange or otherwise, in contravention of
23 such rules and regulations as the Commission may prescribe as necessary or appropriate in the
24 public interest or for the protection of investors, to solicit or to permit the use of his name to
25 solicit any proxy or consent or authorization in respect of any security (other than an exempted
26 security) registered pursuant to section 12 of this title [15 USCS §78l]." Rule 14a-9,
27 promulgated pursuant to §14(a) of the Exchange Act, provides that no Proxy Statement shall
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1 contain "any statement which, at the time and in the light of the circumstances under which it is
2 made, is false or misleading with respect to any material fact, or which omits to state any
3 material fact necessary in order to make the statements therein not false or misleading or
4 necessary to correct any statement in any earlier communication with respect to the solicitation
5 of a proxy for the same meeting or subject matter which has become false or misleading." 17
6 C.F.R. §240.14a-9(a).

7 350. During the Class Period, Lead Plaintiffs and other KLA's shareholders were
8 solicited to vote to elect certain directors, among other proposals. In 2004, in addition to voting
9 on the election of directors, KLA shareholders were also solicited to approve the Company's
10 2004 Equity Incentive Plan, which included approval of its material terms and performance
11 goals for the purposes of IRC Section 162(m). In 2005, KLA shareholders were solicited to
12 "approve the Company's [IRC] Code Section 162(m) Performance Bonus Plan." A shareholder
13 vote was required to approve these proposals and elect these directors.

14 351. The 2001-2005 Proxy Statements violated Section 14(a) and Rule 14a-9 because
15 they (a) contained false and misleading statements regarding the terms of KLA's grants of stock
16 options pursuant to KLA's Stock Option Plans; (b) misrepresented that the stock options
17 exercise prices would be the Company's stock price market price on the date of the grants
18 when, in fact, the options were backdated to a date when the Company's stock price was lower
19 than on the actual grant date; (c) contained false and misleading statements regarding the
20 directors' compensation; (d) misrepresented that the Company complied with IRC Section
21 162(m), 28 U.S.C. §162(m); (e) contained false and misleading statements regarding the stated
22 philosophy of KLA's Compensation Committee on executive compensation; and (f) contained
23 false and misleading statement regarding management's integrity.

24 352. At the time of the materially false and misleading 2001 through 2005 Proxy
25 Statements, KLA shareholders were ignorant of the true facts. These facts would have been
26 material to a reasonable investor or shareholder in considering how to vote on the election of
27 directors, the approval of the 2004 Equity Incentive Plan or the approval of the Company's IRC
28

1 Section 162(m) Performance Bonus Plan. Thus, the shareholders' corporate suffrage rights
2 were violated.

3 353. Each of the Individual Defendants permitted the use of his or her name to solicit
4 the proxies. In the exercise of reasonable care, defendants should have known that the Proxy
5 Statements were materially false and misleading.

6 354. The misrepresentations in the Proxy Statements were material to KLA
7 shareholders in voting on each Proxy Statement. The Proxy Statements were an essential link
8 in the accomplishment of the continuation of defendants' unlawful stock option backdating
9 scheme, as revelations of the truth would have immediately thwarted a continuation of
10 shareholders' endorsement of the directors' elections and positions as well as approval of the
11 2004 Equity Incentive Plan and the IRC Section 162(m) Performance Bonus Plan.

12 355. Lead Plaintiffs and other members of the Class suffered injury as a result of the
13 material misrepresentations and omissions in the 2001-2005 Proxy Statements.

14 **COUNT IV**

15 **(Fraudulent Violations of Section 14(a) of the Exchange Act and Rule 14a-9 Promulgated**
16 **Thereunder Against All Defendants)**

17 356. Lead Plaintiffs allege a separate and distinct claim herein under Section 14(a) of
18 the Exchange Act for defendants' fraudulent conduct, as opposed to the prior count, which
19 alleges claims for negligent misrepresentations. Lead Plaintiffs repeat and restate each and
20 every allegation contained in the foregoing paragraphs as if fully set forth herein. For purposes
21 of this Claim, Lead Plaintiffs assert violations of Section 14(a) for conduct that was fraudulent
22 in nature.

23 357. While Section 14(a) of the Exchange Act gives rise to liability for negligent
24 misrepresentation, plaintiffs also argue that defendants' intentional violation of Section 14(a)
25 gives rise to a claim under Section 14(a) as well.

26 358. During the Class Period, Lead Plaintiffs and other KLA shareholders were
27 solicited to vote to elect certain directors, among other proposals. In 2004, in addition to voting
28

1 on the election of directors, KLA shareholders were also solicited to approve the Company's
2 2004 Equity Incentive Plan, which included approval of its material terms and performance
3 goals for the purposes of IRC Section 162(m). In 2005, KLA shareholders were solicited to "to
4 approve the Company's [IRC] Section 162(m) Performance Bonus Plan." A shareholder vote
5 was required to approve these proposals and elect these directors.

6 359. The 2001-2005 Proxy Statements violated Section 14(a) and Rule 14a-9 because
7 they (a) contained false and misleading statements regarding the terms of KLA's grants of stock
8 options pursuant to KLA's Stock Option Plans; (b) misrepresented that the stock options
9 exercise prices would be the Company's stock market price on the date of the grants when, in
10 fact, the options were backdated to a date when the Company's stock price was lower than on
11 the actual grant date; (c) contained false and misleading statements regarding the directors'
12 compensation; (d) misrepresented that the Company complied with IRC Section 162(m), 28
13 U.S.C. §162(m); (e) contained false and misleading statements regarding the stated philosophy
14 of KLA's Compensation Committee on executive compensation; and (f) contained false and
15 misleading statement regarding management's integrity.

16 360. At the time of the materially false and misleading 2001-2005 Proxy Statements,
17 KLA shareholders were ignorant of the true facts. These facts would have been material to a
18 reasonable investor or shareholder in considering how to vote on the election of directors, the
19 approval of the 2004 Equity Incentive Plan or the approval the Company's IRC Section 162(m)
20 Performance Bonus Plan. Thus, the shareholders' corporate suffrage rights were violated.

21 361. Each of the Individual Defendants permitted the use of his or her name to solicit
22 the proxies. As detailed above, Defendants knew and/or were deliberately reckless in not
23 knowing that the Proxy Statements were materially false and misleading.

24 362. The misrepresentations in the Proxy Statements were material to KLA
25 shareholders in voting on each Proxy Statement. The Proxy Statements were an essential link
26 in the accomplishment of the continuation of defendants' unlawful stock option backdating
27 scheme, as revelations of the truth would have immediately thwarted a continuation of
28

1 shareholders' endorsement of the directors' elections and positions as well as approval of the
2 2004 Equity Incentive Plan and the IRC Section 162(m) Performance Bonus Plan.

3 363. Lead Plaintiff and other members of the Class suffered injury as a result of the
4 material misrepresentations and omissions in the 2001-2005 Proxy Statements.

5 **COUNT V**

6 **(Violations of Section 20A of the Exchange Act Against KLA, Wallace, Levy, Schroeder,**
7 **Dickerson, Kaufman, Kispert, Elkus, Hall, Barnholt, Urbanek, Tompkins,**
8 **Nichols, Marks, Bingham, Morton and Bond)**

9 364. Lead Plaintiffs repeat and restate each and every allegation contained in the
10 foregoing paragraphs as if fully set forth herein.

11 365. The defendants named in this Count are the defendants who: (a) granted or
12 received backdated options; (b) exercised the backdated options; and/or (c) otherwise sold KLA
13 stock during the Class Period and include KLA, Wallace, Levy, Schroeder, Dickerson,
14 Kaufman, Kispert, Elkus, Hall, Barnholt, Urbanek, Tompkins, Nichols, Marks, Bingham,
15 Morton and Bond.

16 366. Lead Plaintiffs purchased at least one KLA stock contemporaneously with (a) the
17 grant of backdated options to defendants; (b) defendants' exercise of backdated options; and/or
18 (c) sales of KLA stock by defendants named in this Count.

19 367. By virtue of their positions at KLA and the specific facts alleged herein, these
20 defendants were in possession of material, adverse, non-public information about KLA
21 contemporaneously with when backdated options were granted and/or exercised and/or
22 defendants sold their KLA stock to Lead Plaintiffs and members of the Class at artificially
23 inflated prices. For example, defendants were in possession of the material, non-public
24 information regarding (a) the falsity of the Company's financial statements; and (b) the
25 misrepresentations regarding the value of options granted to officers and directors.

26 368. As alleged above, each of the defendants violated Sections 10(b), 14(a) and/or
27 20(a) of the Exchange Act.

28 369. These defendants violated Section 20A of the Exchange Act and applicable rules

1 and regulations thereto by granting and/or receiving backdated options, exercising backdated
2 options and/or selling KLA stock while in possession of material, non-public information about
3 the adverse information detailed herein.

4 370. Lead Plaintiffs and other members of the Class who traded in KLA securities
5 contemporaneously with the grants, exercise of backdated options and/or sales of KLA stock by
6 defendants named in this Count have suffered substantial damages in that they paid artificially
7 inflated prices for KLA stock as a result of the violations of Sections 10(b), 14(a) and 20(a) and
8 Rule 10b-5 and Rule 14a-9 herein described. Moreover, these Class members would not have
9 traded KLA securities at the prices they paid or received, or at all, if they had been aware that
10 the market prices had been artificially inflated by defendants' false and misleading statements
11 and scheme to defraud.

12 371. The defendants named in this Count are required to account for all such stock
13 sales and to disgorge their profits or ill-gotten gains.

14 **Prayer For Relief**

15 **WHEREFORE**, Lead Plaintiffs pray for relief and judgment, as follows:

16 A. Determining that this action is a proper class action, certifying Lead Plaintiffs as
17 class representatives under Rule 23 of the Federal Rules of Civil Procedure and appointing Lead
18 Plaintiffs' Counsel as Class Counsel;

19 B. Awarding compensatory damages in favor of Lead Plaintiffs and the other
20 members of the Class against defendants for all damages sustained as a result of defendants'
21 wrongdoing in an amount to be proven at trial, including pre-judgment and post-judgment
22 interest thereon;

23 C. Awarding disgorgement of all insider trading profits in favor of Lead Plaintiffs
24 and the other members of the Class who purchased contemporaneously with defendants;

25 D. Awarding preliminary and permanent injunctive relief in favor of Lead Plaintiffs
26 and the Class members against defendants, including relief in the form of an order (i) declaring
27 the proxies null and void; (ii) nullifying the corporate action taken as a result of the proxy vote;

(iii) rescinding the amendment to the stock option plan; (iv) declaring the backdated option grants null and void; (v) granting an accounting for and imposition of a constructive trust and/or an asset freeze on defendants' ill-gotten gains; (vi) increasing shareholder participation in decisions regarding all executive compensation; and/or (vii) granting reforms that raise the competency level of directors.

E. Awarding Lead Plaintiffs and the other members of the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

F. Such other and further relief as the Court may deem just and proper.

Demand For Trial By Jury

Pursuant to Rule 38(b) of the Federal Rules of Civil Procedure, Lead Plaintiffs hereby demand trial by jury of all issues that may be so tried.

DATED: March 6, 2007

**BERMAN DEVALERIO PEASE TABACCO
BURT & PUCILLO**

By: /s/ NicoleLavallee
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Members of Plaintiffs' Executive Committee

Exhibit A

KLA-Tencor, Inc.

Analysis of Stock Option Restatement Impact**Quarterly Data (from previous 10-K filings):**

All data in 000s, except per share data

	Originally Reported			Avg Shares	Restatement Charges			Operating Income	% Change	As Restated Net Income (Loss)	EPS	% Change
	Operating Income	Net Income (Loss)	EPS		Operating Income	Net Income (Loss)						
FY 1995 Annual	\$ 156,609	\$ 104,811	\$ 1.34	78,427	\$ (2,904)	\$ (1,866)	\$ 153,705	(2%)	\$ 102,945	\$ 1.31	(2%)	
FY 1996 Annual	\$ 296,266	\$ 196,634	\$ 2.34	84,195	\$ (2,747)	\$ (1,764)	\$ 293,519	(1%)	\$ 194,870	\$ 2.31	(1%)	
FY 1997 Annual	\$ 145,832	\$ 105,396	\$ 1.24	85,203	\$ (2,852)	\$ (1,816)	\$ 142,980	(2%)	\$ 103,580	\$ 1.22	(2%)	
FY 1998 Annual	\$ 164,631	\$ 134,096	\$ 1.52	88,522	\$ (5,219)	\$ (3,358)	\$ 159,412	(3%)	\$ 130,738	\$ 1.48	(3%)	
FY 1999 Annual	\$ (10,334)	\$ 39,212	\$ 0.21	183,344	\$ (17,630)	\$ (11,576)	\$ (27,964)	(171%)	\$ 27,636	\$ 0.15	(30%)	
FY 2000 Annual	\$ 311,541	\$ 253,798	\$ 1.32	192,564	\$ (23,296)	\$ (16,098)	\$ 288,245	(7%)	\$ 237,700	\$ 1.23	(6%)	
FY 2001 Annual	\$ 458,468	\$ 66,683	\$ 0.34	193,435	\$ (59,261)	\$ (41,999)	\$ 399,207	(13%)	\$ 24,684	\$ 0.13	(63%)	
FY 2002 Annual	\$ 244,893	\$ 216,166	\$ 1.10	196,594	\$ (76,582)	\$ (50,482)	\$ 168,311	(31%)	\$ 165,684	\$ 0.84	(23%)	
FY 2003 Annual	\$ 138,722	\$ 137,191	\$ 0.70	194,785	\$ (70,032)	\$ (43,196)	\$ 68,690	(50%)	\$ 93,995	\$ 0.48	(31%)	
FY 2004 Annual	\$ 297,358	\$ 243,701	\$ 1.21	201,799	\$ (53,728)	\$ (31,225)	\$ 243,630	(18%)	\$ 212,476	\$ 1.05	(13%)	
FY 2005 Q1	\$ 156,967	\$ 116,405	\$ 0.58	199,969	\$ (10,407)	\$ (6,133)	\$ 146,560	(7%)	\$ 110,272	\$ 0.55	(5%)	
Q2	\$ 155,508	\$ 122,077	\$ 0.61	200,946	\$ (7,175)	\$ (55)	\$ 148,333	(5%)	\$ 122,022	\$ 0.61	(0%)	
Q3	\$ 154,847	\$ 123,163	\$ 0.61	202,329	\$ (11,212)	\$ (6,276)	\$ 143,635	(7%)	\$ 116,887	\$ 0.58	(5%)	
Q4	\$ 115,240	\$ 105,050	\$ 0.52	201,014	\$ (8,648)	\$ (9,182)	\$ 106,592	(8%)	\$ 95,868	\$ 0.48	(9%)	
Annual	\$ 582,562	\$ 466,695	\$ 2.32	201,014	\$ (37,442)	\$ (21,646)	\$ 545,120	(6%)	\$ 445,049	\$ 2.21	(5%)	
FY 2006 Q1	\$ 80,838	\$ 76,678	\$ 0.38	202,715	\$ (5,848)	\$ (1,191)	\$ 74,990	(7%)	\$ 75,487	\$ 0.37	(2%)	
Q2	\$ 76,515	\$ 76,649	\$ 0.38	203,345	\$ (1,521)	\$ (44)	\$ 74,994	(2%)	\$ 76,605	\$ 0.38	(0%)	
Q3	\$ 87,345	\$ 98,143	\$ 0.48	204,318	\$ (2,418)	\$ (1,459)	\$ 84,927	(3%)	\$ 96,684	\$ 0.47	(1%)	
Q4							\$ 74,880	N/M	\$ 131,676	\$ 0.65	N/M	
Annual							\$ 309,791	N/M	\$ 380,452	\$ 1.86	N/M	

Q4 not restated, because not previously reported →

Q4 not restated, because not previously reported →

EXHIBIT 5

1

PROXY STATEMENT PURSUANT TO SECTION 14(a) OF THE SECURITIES EXCHANGE ACT OF 1934 (Amendment No.)

Filed by the Registrant ☒ [X]

Filed by a Party other than the Registrant ☐ []

Check the appropriate box:

☐ [] Preliminary Proxy Statement

☐ [] Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

☒ [X] Definitive Proxy Statement

☐ () Definitive Additional Materials

☐ () Soliciting Material Pursuant to Section 240.14a-11(c) or Section 240.14a-12

KLA-TENCOR CORPORATION

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

☒ [X] No fee required.

☐ () Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

5) Total fee paid:

☐ [] Fee previously paid.

☐ [] Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount Previously Paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

2

KLA-TENCOR CORPORATION
NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
NOVEMBER 17, 1998

To the Stockholders:

NOTICE IS HEREBY GIVEN that the Annual Meeting of Stockholders of KLA-Tencor Corporation (the "Company"), a Delaware corporation, will be held on Tuesday, November 17, 1998 at 11:00 a.m., local time, at the Company's offices located at One Technology Drive, Milpitas, California 95035, for the following purposes:

1. To elect four Class III directors to serve for a three year term and until their successors are elected.
2. To approve amendments to the 1997 Employee Stock Purchase Plan (the "1997 Purchase Plan") to increase the number of shares of Common Stock of the Company (the "Common Stock") reserved for issuance thereunder by 1,000,000 shares.
3. To approve amendments to the 1997 Purchase Plan to increase the number of shares of Common Stock reserved for issuance thereunder on the first day of each subsequent fiscal year by the lesser of (a) 2,000,000 shares or (b) the number of shares which the Company estimates (based on the previous 12-month period) it will be required to issue under the 1997 Purchase Plan during the forthcoming fiscal year.
4. To approve the 1998 Outside Director Option Plan and to reserve for issuance thereunder 1,000,000 shares of the Common Stock.
5. To ratify the appointment of PricewaterhouseCoopers LLP as independent accountants of the Company for the fiscal year ending June 30, 1999.
6. To transact such other business as may properly come before the meeting and any adjournments thereof.

The foregoing items of business are more fully described in the Proxy Statement accompanying this Notice.

Only stockholders of record at the close of business on September 18, 1998 are entitled to notice of and to vote at the meeting.

Sincerely,

Larry W. Sonsini
Secretary

San Jose, California
September 30, 1998

YOUR VOTE IS IMPORTANT

ALL STOCKHOLDERS ARE CORDIALLY INVITED TO ATTEND THE MEETING IN PERSON, HOWEVER, TO ASSURE YOUR REPRESENTATION AT THE MEETING, YOU ARE REQUESTED TO COMPLETE, SIGN AND DATE THE ENCLOSED PROXY CARD AS PROMPTLY AS POSSIBLE AND RETURN IT IN THE ENCLOSED ENVELOPE. ANY STOCKHOLDER ATTENDING THE MEETING MAY VOTE IN PERSON EVEN IF HE OR SHE RETURNED A PROXY.

KLA-TENCOR CORPORATION

PROXY STATEMENT

INFORMATION CONCERNING SOLICITATION AND VOTING

GENERAL

The enclosed Proxy is solicited on behalf of KLA-Tencor Corporation (the "Company") for use at the Annual Meeting of Stockholders to be held on Tuesday, November 17, 1998 at 11:00 a.m., local time, or at any adjournment(s) thereof (the "Annual Meeting"), for the purposes set forth herein and in the accompanying Notice of Annual Meeting of Stockholders. The Annual Meeting will be held at the Company's offices at One Technology Drive, Milpitas, California 95035. The Company's principal executive offices are located at 160 Rio Robles, San Jose, California 95134 and its telephone number is (408) 875-4200.

These proxy solicitation materials were mailed on or about September 30, 1998 to all stockholders entitled to vote.

RECORD DATE

Stockholders of record at the close of business on September 18, 1998 are entitled to notice of and to vote at the Annual Meeting. As of the record date 87,321,556 shares of the Company's Common Stock, \$0.001 par value, were issued and outstanding.

REVOCABILITY OF PROXIES

Any Proxy given pursuant to this solicitation may be revoked by the person giving it at any time before its use by delivering to the Company a written notice of revocation or a duly executed proxy bearing a later date or by attending the meeting and voting in person.

QUORUM; ABSTENTIONS; BROKER NON-VOTES

The required quorum for the transaction of business at the Annual Meeting is a majority of the votes eligible to be cast by holders of shares of Common Stock issued and outstanding on the record date. Shares that are voted "FOR," "AGAINST," "ABSTAIN" or "WITHHELD FROM" a matter are treated as being present at the Annual Meeting for purposes of establishing a quorum and are also treated as shares entitled to vote at the Annual Meeting (the "Votes Cast") with respect to such matter.

Abstentions will be counted for purposes of determining both (i) the presence or absence of a quorum for the transaction of business and (ii) the total number of Votes Cast with respect to a proposal (other than the election of directors). Accordingly, abstentions will have the same effect as a vote against the proposal.

Broker non-votes will be counted for purposes of determining the presence or absence of a quorum for the transaction of business, but will not be counted for purposes of determining the number of Votes Cast with respect to the particular proposal on which the broker has expressly not voted. Accordingly, broker non-votes will not affect the outcome of the voting on a proposal that requires a majority of the Votes Cast (such as the approval of a plan).

VOTING AND SOLICITATION

On all matters other than the election of directors, each share has one vote. See "PROPOSAL ONE -- REQUIRED VOTE."

The cost of soliciting proxies will be borne by the Company. The Company has retained the services of Skinner & Co. to aid in the solicitation of proxies from brokers, bank nominees and other institutional owners. The Company estimates that it will pay Skinner & Co. a fee not to exceed \$5,000 for its services and will reimburse it for certain out of pocket expenses estimated to be \$45,000. In addition, the Company may

reimburse brokerage firms and other persons representing beneficial owners of shares for their expenses in forwarding solicitation material to such beneficial owners. Proxies may be solicited by certain of the Company's directors, officers and regular employees, without additional compensation, personally or by telephone or telegram.

DEADLINE FOR RECEIPT OF STOCKHOLDER PROPOSALS

Proposals of stockholders of the Company which are intended to be presented by such stockholders at the Company's annual meeting in 1999 must be received by the Company no later than June 2, 1999 and otherwise be in compliance with applicable laws and regulations in order for such proposals to be considered for possible inclusion may be included in the Company's proxy statement and form of proxy relating to that meeting.

The attached proxy card grants the proxy holders discretionary authority to vote on any matter raised at the Annual Meeting. If a stockholder intends to submit a proposal at the Company's annual meeting in 1999, which proposal is not intended to be included in the Company's proxy statement and form of proxy relating to that meeting, the stockholder should give appropriate notice no later than August 16, 1999. If such a stockholder fails to submit the proposal by such date the Company will not be required to provide any information about the nature of the proposal in its proxy statement and the proxy holders will be allowed to use their discretionary voting authority if the proposal is raised at the Company's annual meeting in 1999.

SECURITY OWNERSHIP

PRINCIPAL STOCKHOLDERS

As of June 30, 1998, the following persons were known to the Company to be beneficial owners of more than 5% of the Company's Common Stock:

NAME AND ADDRESS -----	NUMBER OF SHARES OWNED -----	PERCENTAGE TOTAL (1) -----
Capital Guardian Trust Co.(2)..... 333 South Hope Street Los Angeles, CA 90071	7,726,700	8.8%
Jennison Associates Capital Corp.(3)..... 466 Lexington Ave New York, NY 10017	5,485,500	6.3%
FMR Corp.(4)..... 82 Devonshire Street Boston, MA 02109	6,347,503	7.3%
Neuberger & Berman, LLC; Neuberger & Berman Management Incorporated(5)..... 605 Third Ave., New York, NY 10158-3698	6,411,113	7.3%
The Prudential Insurance Company of America(6)..... Prudential Plaza Newark, NJ 07102	5,685,552	6.5%

(1) Based on 87,443,592 outstanding shares of Common Stock as of June 30, 1998.

(2) Based on information provided pursuant to Schedule 13G filed with the Securities and Exchange Commission (the "SEC") on July 9, 1998. This share amount includes 1,037,100 shares held by Capital International Limited; 805,400 shares held by Capital International S.A. and 112,100 shares held by Capital International, Inc., affiliated entities of Capital Guardian Trust Co. (the "Reporting Entity"). Previously, The Capital Group Companies, Inc., the parent holding company of the Reporting Entity and its listed affiliated entities, reported the beneficial ownership of all of such shares. On July 9, 1998 it filed a Schedule 13G indicating that it retained no beneficial ownership of shares held by its independent investment management affiliates.

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- (3) Based on information provided pursuant to Schedule 13G/A filed with the SEC on February 12, 1998. Jennison Associates Capital Corp. ("Jennison") is an institutional investor and is considered the beneficial owner only as a result of its position as manager of the funds which own the shares of Common Stock of the Company. Jennison is an autonomous, wholly-owned subsidiary of The Prudential Insurance Company of America ("Prudential"). As such, the shares of Common Stock reported by Jennison are also included in the shares of Common Stock reported by Prudential in its reporting obligations with the SEC. (See Note 6 below.)
- (4) Based on information provided pursuant to Schedule 13G filed with the SEC on February 10, 1998. FMR Corp. is a parent holding company and includes shares held by Fidelity Management & Research Company, Fidelity Management Trust Company and Fidelity International Limited.
- (5) Based on information provided pursuant to Schedule 13G filed with the SEC on February 12, 1998. This number includes 4,373,850 shares held by Neuberger & Berman's various mutual funds, for which Neuberger & Berman LLC and Neuberger & Berman Management Inc. serve as sub-advisor and investment manager, respectively.
- (6) Based on information provided pursuant to Schedule 13G/A filed with the SEC on February 9, 1998. Prudential presently holds 22,400 shares of Common Stock of the Company for the benefit of its general account. In addition, Prudential may have direct or indirect voting and/or investment discretion over 5,663,152 shares, including 5,485,500 shares held by Jennison, a wholly-owned subsidiary of Prudential (see Note 3 above).

SECURITY OWNERSHIP OF MANAGEMENT

The following table sets forth the beneficial ownership of Common Stock of the Company as of September 18, 1998 (the most recent practicable date) by all directors and nominees (naming them), each of the named executive officers set forth in the Summary Compensation Table and by all directors and current executive officers as a group:

NAME	AMOUNT OWNED	APPROXIMATE PERCENTAGE OWNED*
Kenneth Levy(1)	1,874,170	2.15%
Jon D. Tompkins(2)	160,869	**
Kenneth L. Schroeder(3)	449,729	**
James W. Bagley(4)	20,051	**
Edward W. Barnholt(5)	5,213	**
Leo J. Chamberlain(6)	27,067	**
Richard J. Elkus, Jr.(7)	75,937	**
Dean O. Morton(8)	15,051	**
Yoshio Nishi(9)	32,956	**
Samuel Rubinovitz(10)	13,623	**
Dag Tellefsen(11)	14,206	**
Lida Urbanek(12)	818,679	**
Robert J. Boehlke(13)	102,526	**
Gary E. Dickerson(14)	95,190	**
Graham J. Siddall(15)	204,384	**
All directors and executive officers as a group (22 persons)(16)	4,354,172	4.99%

* Based on 87,321,556 outstanding shares of the Common Stock of the Company as of September 18, 1998.

** Less than 1%

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- (1) Includes 353,093 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998 and 231,000 shares which are held in trust for the benefit of Mr. Levy's children.
- (2) Includes 145,072 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998.
- (3) Includes 325,093 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998.
- (4) Includes 20,051 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998.
- (5) Includes 5,213 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998.
- (6) Includes 5,070 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998.
- (7) Includes 937 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998.
- (8) Includes 10,051 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998.
- (9) Includes 32,956 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998.
- (10) Includes 9,623 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998.
- (11) Includes 13,107 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998.
- (12) Includes 3,560 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998 and 151,500 shares which are held by Mrs. Urbanek's children.
- (13) Includes 98,829 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998.
- (14) Includes 92,688 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998.
- (15) Includes 173,966 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998.
- (16) Includes 1,715,860 shares, options for which are presently exercisable or will become exercisable within 60 days of September 18, 1998.

PROPOSAL ONE

TO ELECT FOUR CLASS III DIRECTORS TO SERVE FOR A
THREE YEAR TERM AND UNTIL THEIR SUCCESSORS ARE ELECTED.

NOMINEES

The Company has a classified board of twelve directors consisting of four Class I directors (Kenneth Levy, Samuel Rubinovitz, Jon D. Tompkins and Lida Urbanek), three Class II directors (Leo J. Chamberlain, Richard J. Elkus, Jr. and Dag Tellefsen) and five Class III directors (James W. Bagley, Edward W. Barnholt, Dean O. Morton, Yoshio Nishi and Kenneth L. Schroeder). The Class I directors and the Class II directors will serve until the annual meetings of stockholders to be held in 1999 and 2000 respectively, or until their respective successors are duly elected and qualified. At each annual meeting of stockholders, directors are elected for a full term of three years to succeed those directors whose terms expire at the annual meeting.

The terms of the Class III directors will expire on the date of the Annual Meeting. Yoshio Nishi has declined to stand for re-election. Accordingly, four of the five Class III directors of the Board of Directors are to be elected at the Annual Meeting. The nominees for election by the stockholders to these four positions are James W. Bagley, Edward W. Barnholt, Dean O. Morton and Kenneth L. Schroeder. If elected, the nominees will serve as directors until the Company's annual meeting of stockholders in 2001, or until their successors are elected and qualified. If any of the nominees declines to serve or becomes unavailable for any reason, or if a vacancy occurs before the election, the proxies may be voted for such substitute nominees as management may designate. The proxy holders also have been advised that, in the event any of the nominees shall not be available for election, a circumstance that is not currently expected, they may vote for the election of substitute nominees in accordance with their judgment. If additional persons are nominated for election as directors, the proxy holders intend to vote all proxies received by them in such a manner in accordance with cumulative voting (if invoked) as will assure the election of as many of the nominees as possible and, in such event, the specific nominees to be voted for will be determined by the proxy holders.

If a quorum is present and voting, the four nominees for Class III directors receiving the highest number of votes will be elected as Class III directors. Abstentions and shares held by brokers that are not present, but not voted because the brokers were prohibited from exercising discretionary authority, i.e., "broker non-votes," will be counted as present in determining if a quorum is present.

The following table sets forth certain information with respect to the Company's Board of Directors.

NAME OF DIRECTOR -----	AGE ---	POSITION -----	DIRECTOR SINCE -----
Jon D. Tompkins.....	58	Chairman of the Board	1997
Kenneth Levy.....	55	Chief Executive Officer	1975
Kenneth L. Schroeder.....	52	President and Chief Operating Officer	1991
James W. Bagley.....	59	Director	1997
Edward W. Barnholt.....	55	Director	1995
Leo J. Chamberlain.....	68	Director	1982
Richard J. Elkus, Jr.....	63	Director	1997
Dean O. Morton.....	66	Director	1997
Yoshio Nishi.....	58	Director	1989
Samuel Rubinovitz.....	68	Director	1990
Dag Tellefsen.....	56	Director	1978
Lida Urbanek.....	55	Director	1997

There are no family relationships between or among any directors or executive officers of the Company.

JON D. TOMPKINS has been Chairman of the Board since July 1, 1998. From April 30, 1997 until July 1, 1998 he was Chief Executive Officer and a Director of the Company. From 1991 until April 30, 1997 he was President and Chief Executive Officer of Tencor Instruments, a manufacturer of wafer inspection, film measurement and metrology systems for the semiconductor industry ("Tencor") prior to its merger with the Company. He was a director of Tencor from 1991 until April 1997 and was appointed chairman of the board of directors of Tencor in November 1993. He currently serves on the boards of directors of Varian Corporation and ESI Incorporated as well as chairman of the board of SEMI/SEMATECH, a private research and development consortium of U.S. semiconductor equipment and materials companies.

KENNETH LEVY is a founder of the Company and since July 1, 1998 has been Chief Executive Officer and a Director. From 1975 until April 30, 1997 he was Chairman of the Board and Chief Executive Officer. From April 30, 1997 until June 30, 1998 he was Chairman of the Board. He currently serves on the boards of directors of Ultratech Stepper, Inc. and Integrated Process Equipment Corporation.

KENNETH L. SCHROEDER has been President, Chief Operating Officer and Director of the Company since November 1991. He currently serves on the board of directors of GaSonics International.

JAMES W. BAGLEY has been a Director of the Company since April 30, 1997. He was a director of Tencor from June 1993 until April 30, 1997. He has been chief executive officer and a director of Lam Research Corporation, a manufacturer of semiconductor processing equipment, since August 1997. From May 1996 until August 1997 he was chairman of the board and chief executive officer of OnTrak Systems, Inc. until its merger with Lam Research Corporation in August 1997. From December 1987 until December 1993, Mr. Bagley was president and chief operating officer for Applied Materials, Inc., a manufacturer of wafer fabrication systems to the semiconductor industry. From January 1994 until October 1995 he was vice chairman and chief operating officer of Applied Materials, Inc., and vice chairman from November 1995 until May 1996. Mr. Bagley currently serves on the boards of directors of Teradyne, Inc., Kulicke & Soffa Industries, Inc., Micron Technology, Inc., and SEMI/SEMATECH.

EDWARD W. BARNHOLT has been a Director of the Company since 1995. Mr. Barnholt joined Hewlett-Packard Company, a manufacturer of electronic and computer equipment in December 1966. From 1988 to 1990 he was general manager of the Electronics Instruments Group of Hewlett-Packard Company. In July 1988, he was elected vice president and in November 1993 he was elected senior vice president of Hewlett-Packard Company. Mr. Barnholt is currently executive vice president and general manager of the Test and Measurement Organization of Hewlett Packard Company.

LEO J. CHAMBERLAIN has been a Director of the Company since 1982. He is a private investor.

RICHARD J. ELKUS, JR. has been a Director of the Company since April 30, 1997. He was executive vice president and vice chairman of the board of directors of Tencor from February 1994 until April 30, 1997. Previously, he was with Prometrix Corporation from September 1983 until February 1994 where he held the positions of chairman and chief executive officer until its merger with Tencor in February 1994. He currently serves on the boards of directors of Voyan Technology and Lam Research Corporation.

DEAN O. MORTON has been a Director of the Company since April 30, 1997. From June 1993 until April 30, 1997 he was a director of Tencor. In October 1992 Mr. Morton retired as executive vice president, chief operating officer and a director of Hewlett-Packard Company, where he held various positions from 1960 until his retirement. Mr. Morton currently serves as chairman of the board of Centigram Communications Corporation and as a director of ALZA Corporation, The Clorox Company, BEA Systems Inc. and Raychem Corporation. Mr. Morton is also a trustee of the Metropolitan Series Fund and State Street Research Funds Group and Portfolios Inc.

YOSHIO NISHI has been a Director of the Company since 1989. Since May 1995 he has been director of research and development and senior vice president of the Semiconductor Group of Texas Instruments Incorporated, a manufacturer of integrated circuits and electronic equipment. From January 1986 to April 1995 he was director of the Silicon Process Laboratory for Hewlett-Packard Laboratories, a semiconductor technology research facility affiliated with Hewlett-Packard Company.

SAMUEL RUBINOVITZ has been a Director of the Company since 1990. He previously served as a Director of the Company from October 1979 to January 1989. From April 1989 to January 1994 he was executive vice president of EG&G, Inc., a diversified manufacturer of scientific instruments and electronic, optical and mechanical equipment. He currently serves on the boards of directors of Richardson Electronics, Inc., LTX Corporation and Kronos, Inc.

DAG TELLEFSEN has been a Director of the Company since 1978. He is the general partner of the Investment Manager of Glenwood Ventures I and II, venture capital funds. He currently serves on the boards of directors of Iwerks Entertainment Corporation, Aptix, Metorex International and Aeneid.

LIDA URBANEK has been a Director of the Company since April 30, 1997. She is a private investor. She was a director of Tencor from August 1991 until April 30, 1997.

BOARD MEETINGS AND COMMITTEES

The Board of Directors of the Company held a total of five meetings during the fiscal year ended June 30, 1998. The Board of Directors has an Audit Committee, a Compensation Committee and a Nominating Committee.

The Audit Committee, which consists of Mr. Morton, Mr. Rubinovitz and Mr. Tellefsen, held three meetings during the last fiscal year. The Audit Committee recommends engagement of the Company's independent accountants, and is primarily responsible for approving the services performed by the Company's independent accountants and for reviewing and evaluating the Company's accounting principles and its system of internal accounting controls. The Compensation Committee, which consists of Mr. Bagley, Mr. Chamberlain and Mrs. Urbanek, held three meetings during the last fiscal year. The Compensation Committee reviews and approves the Company's executive compensation policy and makes recommendations concerning the Company's employee benefit plans. The Nominating Committee, which consists of Mr. Barnholt, Mr. Levy and Mr. Tompkins did not hold a meeting during the last fiscal year. A unanimous group of the disinterested members of the board of directors nominated the four Class III directors for election, with Mr. Nishi declining to stand for reelection. The Nominating Committee is primarily responsible for identifying and evaluating the qualifications of all candidates for election to the Board of Directors. The Nominating Committee will consider nominations recommended by stockholders. Stockholders wishing to submit nominations must notify the Company of their intent to do so and provide the Company with certain information set forth in the Company's bylaws on or before the date on which stockholder proposals to be included in the proxy statement for the stockholder meeting must be received by the Company.

During the fiscal year ended June 30, 1998, all incumbent Directors attended at least 75% of the aggregate number of meetings of the Board of Directors and meetings of the committees of the Board on which they served.

COMPENSATION OF DIRECTORS

Members of the Board of Directors who are not employees of the Company receive an annual fee of \$15,000 and \$1,000 for each meeting they attend (\$500 if participation is by telephone), plus expenses. Committee members receive \$500 per committee meeting they attend (\$250 if participation is by telephone). The Company's Outside Directors Stock Option Plan (the "Director Plan") as adopted by the Board of Directors and approved by the stockholders, provides for the grant of an option to purchase 2,500 shares of Common Stock of the Company to each of the Company's non-employee directors on the date on which such person is elected a director. Thereafter, each non-employee director is automatically granted an option to purchase 2,500 shares of Common Stock of the Company on the anniversary of such date. The Director Plan provides that the exercise price shall be equal to the fair market value of the Common Stock on the date of grant of the option. Options granted pursuant to the Director Plan have a term of ten years with 25% vesting after 12 months and the remainder vesting monthly over the following 36 months, but only while the optionee is a director of the Company, within six months after death or within 30 days after the optionee ceases to serve as a director of the Company. The Company plans to terminate the Director Plan if the stockholders approve Proposal Four hereunder.

If the stockholders approve Proposal Four hereunder, the non-employee Directors shall receive benefits under the 1998 Outside Director Plan ("1998 Director Plan") and no additional options will be granted under the Director Plan and it will be terminated. Under the 1998 Director Plan, each non-employee Director ("Outside Director") shall receive a nonstatutory option to purchase 10,000 shares of Common Stock as of the date on which such director first becomes an Outside Director (the "First Option"). Accordingly, none of the existing directors will be granted a First Option. In addition, each Outside Director shall automatically be granted a nonstatutory option to purchase an additional 5,000 shares of Common Stock on the date of the subsequent annual meetings on which he or she remains an Outside Director (the "Subsequent Option"). The term of options granted under the 1998 Director Plan may not exceed 10 years. The 1998 Director Plan provides that the exercise price shall be equal to the fair market value of the Common Stock on the date of

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grant of the option. Options granted under the 1998 Director Plan shall become exercisable immediately upon the date of grant.

REQUIRED VOTE

Directors shall be elected by a plurality of the votes of the shares of the Company's Common Stock entitled to vote and represented in person or by proxy at the Annual Meeting. Votes against, votes withheld and broker non-votes have no legal effect on the election of directors due to the fact that such elections are by a plurality. Every stockholder voting for the election of directors may cumulate such stockholder's votes and give one candidate a number of votes equal to the number of directors to be elected multiplied by the number of votes to which the stockholder's shares are entitled, or may distribute the stockholder's votes on the same principle among as many candidates as the stockholder thinks fit, provided that votes cannot be cast for more than the number of directors to be elected. However, no stockholder shall be entitled to cumulate votes unless the candidate's name has been placed in nomination prior to the voting and the stockholder, or any other stockholder, has given notice at the Annual Meeting prior to the voting of the intention to cumulate the stockholder's votes. The proxy holders will exercise discretionary authority to cumulate votes in the event that additional persons are nominated at the Annual Meeting for election of directors.

MANAGEMENT RECOMMENDS A VOTE FOR EACH OF THE CLASS III NOMINEES LISTED ABOVE.

PROPOSAL TWO

APPROVAL OF AMENDMENT TO THE 1997 EMPLOYEE STOCK PURCHASE PLAN TO INCREASE THE NUMBER OF SHARES OF COMMON STOCK RESERVED FOR ISSUANCE THEREUNDER BY 1,000,000 SHARES.

GENERAL

As of the date hereof 200,000 shares of the Company's Common Stock have been reserved for issuance under the Company's 1997 Employee Stock Purchase Plan (the "1997 Purchase Plan"). In August 1998, the Board of Directors adopted an amendment to the 1997 Purchase Plan, subject to stockholder approval, to increase the number of shares reserved for issuance thereunder by 1,000,000 shares in fiscal 1999, to a total of 1,200,000 reserved shares. As of June 30, 1998, 195,598 shares of Common Stock had been issued under the 1997 Purchase Plan at an average price of \$23.5344 per share and 4,402 shares remained available for purchase.

The 1997 Purchase Plan was adopted in 1997 and stockholder approval was obtained at the 1997 annual meeting of stockholders with the intention of phasing out the Company's 1981 Employee Stock Purchase Plan (the "1981 Purchase Plan") over the two year period ending June 30, 1999. The Company estimates that it will utilize the remaining available shares under the 1997 Purchase Plan leaving an insufficient number of shares for issuance in the exercise periods throughout the phase out of the 1981 Purchase Plan in fiscal 1999.

The Board of Directors believes that it is in the best interests of the Company to provide employees with an opportunity to purchase Common Stock of the Company through payroll deductions. In addition, the Board of Directors believes that the shares remaining available for issuance pursuant to the 1997 Purchase Plan are insufficient for such purpose. Accordingly, at the Annual Meeting, the stockholders are being requested to consider and to approve an amendment of the 1997 Purchase Plan to increase the number of shares reserved for issuance thereunder by 1,000,000 shares which the Company believes is a sufficient number of shares to allow the Company to continue to phase out the 1981 Purchase Plan through the next fiscal year.

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The description of the 1997 Purchase Plan that follows Proposal Three is incorporated herein by this reference.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR APPROVAL OF THE AMENDMENT TO THE 1997 EMPLOYEE STOCK PURCHASE PLAN TO INCREASE THE NUMBER OF SHARES RESERVED FOR ISSUANCE THEREUNDER BY 1,000,000 SHARES.

PROPOSAL THREE

APPROVAL OF AMENDMENTS TO THE 1997 PURCHASE PLAN TO PROVIDE FOR AN AUTOMATIC INCREASE TO THE SHARES FOR ISSUANCE THEREUNDER ON THE FIRST DAY OF EACH NEW FISCAL YEAR

GENERAL

As of the date hereof 200,000 shares of the Company's Common Stock have been reserved for issuance under the 1997 Purchase Plan. In August 1998, in addition to the amendment described in Proposal Two above, the Board of Directors adopted an amendment to the 1997 Purchase Plan, subject to stockholder approval, to increase the number of shares reserved for issuance thereunder on the first day of each subsequent fiscal year (beginning on July 1, 1999) by the lesser of (a) 2,000,000 shares or (b) the number of shares which the Company estimates (based on the previous 12-month period) it will be required to issue under the 1997 Purchase Plan during the forthcoming fiscal year. As of June 30, 1998, 195,598 shares of Common Stock had been issued under the 1997 Purchase Plan at an average price of \$23.5344 per share and 4,402 shares remained available for purchase.

The Company sought stockholder approval of the 1997 Purchase Plan at the 1997 annual meeting of stockholders with the intention of phasing out the Company's 1981 Purchase Plan over the two year period ending June 30, 1999. Following the phase out of the 1981 Purchase Plan, the 1997 Purchase Plan will need additional shares to replace the shares issued thereunder.

As described in Proposal Two above, the Company will have phased out the 1982 Purchase Plan by June 30, 1999. Thereafter, the 1997 Purchase Plan will be the Company's sole employee stock purchase plan. The Board of Directors believes that it is in the best interests to provide employees with an opportunity to purchase Common Stock of the Company through payroll deductions. The Board believes that the 1,000,000 shares of Common Stock being added to the 1997 Purchase Plan pursuant to Proposal Two will be sufficient to cover the requirements of this plan through June 30, 1999. To simplify the administration of the 1997 Purchase Plan thereafter, the Board has approved the proposed amendment which provides for automatic periodic additions of a specified number of shares of Common Stock to the plan without the need for additional stockholder approval. This amendment is intended to ensure that the 1997 Purchase Plan will continue to have a reasonable number of shares available to meet its requirements for the remainder of its term.

The description of the 1997 Purchase Plan that follows Proposal Three is incorporated herein by this reference.

REQUIRED VOTE -- PROPOSALS TWO AND THREE

The affirmative vote of a majority of the Votes Cast will be required to approve the amendments to the 1997 Purchase Plan.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR APPROVAL OF THE AMENDMENTS TO THE 1997 PURCHASE PLAN TO PROVIDE FOR AN AUTOMATIC INCREASE TO THE SHARES RESERVED FOR ISSUANCE THEREUNDER ON THE FIRST DAY OF EACH NEW FISCAL YEAR.

SUMMARY OF THE 1997 PURCHASE PLAN, AS AMENDED

The essential features of the 1997 Purchase Plan, as amended, are outlined below; provided however, that the following summary is qualified in its entirety by the specific language of the 1997 Purchase Plan, as amended, a copy of which is available at no charge to any stockholder upon request.

Purpose

The purpose of the 1997 Purchase Plan is to provide employees of the Company and its foreign subsidiaries designated by the Board of Directors of the Company with an opportunity to purchase Common Stock of the Company through payroll deductions.

Administration

The 1997 Purchase Plan is administered by the Board of Directors or a committee appointed by the Board of Directors. The Board of Directors has the discretion to delegate routine matters to management. All questions of interpretation or application of the 1997 Purchase Plan are determined in the sole discretion of the Board of Directors, and its decisions are final and binding upon all participants. The Board of Directors may determine, in its sole discretion, the requirements and conditions of participation, if any, by employees of foreign subsidiaries. In the event that the Board of Directors determines that the ongoing operation of the 1997 Purchase Plan may result in unfavorable financial accounting consequences, the Board of Directors may in any manner it determines, in its sole discretion, and, to the extent necessary or desirable, modify or amend the 1997 Purchase Plan, including, but not limited to altering the purchase price for any offering period including an offering period underway at the time of the change in purchase price. Such modifications or amendments shall not require stockholder approval or the consent of any participants in the 1997 Purchase Plan. Members of the Board of Directors who are eligible employees of the Company are permitted to participate in the 1997 Purchase Plan. Members of the Board of Directors will receive no additional compensation for their services in connection with the administration of the 1997 Purchase Plan. All payroll deductions received or held by the Company may be used by the Company for any corporate purpose.

Eligibility

Any person who is employed by the Company or its subsidiaries for at least 20 hours per week and more than five months in a calendar year is eligible to participate in the 1997 Purchase Plan.

Employees of foreign subsidiaries may be subject to additional requirements and restrictions depending upon applicable local law. As of June 30, 1998, approximately 3,300 employees were participating in the 1997 Purchase Plan.

Offering Dates

The 1997 Purchase Plan is implemented by 24-month offering periods (each an "Offering Period"), commencing on January 1 and July 1 of each year. Each Offering Period is composed of four consecutive six-month purchase periods (each a "Purchase Period"). The Board of Directors has the power to alter the duration of the Offering Periods without stockholder approval.

Eligible employees become participants in the 1997 Purchase Plan by delivering to the Company a subscription agreement authorizing payroll deductions. An eligible employee may participate in an Offering Period only if, as of the enrollment date of such Offering Period, such employee is not participating in the 1981 Purchase Plan or in any prior Offering Period under the 1997 Purchase Plan which is continuing at the time of such proposed enrollment. An employee who becomes eligible to participate in the 1997 Purchase Plan after the commencement of an Offering Period may not participate until the commencement of the next Offering Period.

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Purchase Price

The purchase price per share at which shares are sold under the 1997 Purchase Plan shall be 85% of the lesser of (a) the fair market value of the shares of Common Stock on the first day of such Offering Period, and (b) the fair market value of the shares of Common Stock at the time of exercise of a participant's purchase option. The fair market value of the Common Stock on a given date shall be determined by the Board of Directors based on the closing price of the Company's Common Stock on such date as reported on the Nasdaq National Market.

Payment of Purchase Price; Payroll Deductions

The purchase price for the shares is accumulated by payroll deductions during the Offering Period. The deductions may not exceed 10% of a participant's eligible compensation. A participant may institute decreases in the rate of payroll deductions at any time and such decreases are immediately effective. Increases in the rate of payroll deductions are effective as of the commencement of the next Offering Period.

All payroll deductions are credited to the participant's account under the 1997 Purchase Plan; no interest accrues on the payroll deductions. All payroll deductions received or held by the Company may be used by the Company for any corporate purpose and such payroll deductions need not be segregated.

Purchase of Stock; Exercise of Option

At the beginning of each Offering Period, by executing a subscription agreement to participate in the 1997 Purchase Plan, each employee is in effect granted an option to purchase shares of Common Stock. The maximum number of shares placed under option to a participant in an Offering Period is determined by dividing \$20,000 by 85% of the fair market value of the Common Stock at the beginning of the Offering Period. Notwithstanding the foregoing, no employee may make aggregate purchases of stock of the Company and its subsidiaries under the 1997 Purchase Plan and any other employee stock purchase plans qualified as such under Section 423(b) of the Internal Revenue Code of 1986, as amended (the "Code") in excess of \$25,000 (determined using the fair market value of the shares at the time the option is granted) during any calendar year.

Withdrawal

While each employee in the 1997 Purchase Plan is required to sign a subscription agreement authorizing payroll deductions to participate, a participant may terminate his or her participation in the 1997 Purchase Plan at any time by signing and delivering to the Company a notice of withdrawal from the 1997 Purchase Plan. All of the participant's accumulated payroll deductions will be paid to the participant promptly after receipt of his or her notice of withdrawal and his or her participation in the current Offering Period will be automatically terminated, and no further payroll deductions for the purchase of shares will be made during the Offering Period. No resumption of payroll deductions will occur on behalf of such participant unless such participant re-enrolls in the 1997 Purchase Plan by delivering a new subscription agreement to the Company during the applicable open enrollment period preceding the commencement of a subsequent Offering Period. A participant's withdrawal from the 1997 Purchase Plan during an Offering Period does not have any effect upon such participant's eligibility to participate in subsequent Offering Periods under the 1997 Purchase Plan.

Termination of Employment

Termination of a participant's employment for any reason, including retirement or death, cancels his or her participation in the 1997 Purchase Plan immediately. In such event, the payroll deductions credited to the participant's account will be returned to such participant or, in the case of death, to the participant's legal representative.

Capital Changes

If any change is made in the capitalization of the Company, such as stock splits or stock dividends, which results in an increase or decrease in the number of shares of Common Stock outstanding or in the event of any merger, sale or other reorganization, appropriate adjustments shall be made by the Company in the 1997 Purchase Plan's reserve and the number and class of shares subject to outstanding purchase options and in the purchase price per share. Notwithstanding such adjustment, if in a transaction the stockholders of the Company no longer retain at least a majority of the beneficial interest in the voting stock of the Company following such transaction ("Transfer of Control"), the Board of Directors may, in its sole discretion (a) provide that the purchase options become fully exercisable prior to the date of the Transfer of Control, (b) provide that such successor entity assume the Company's obligations under the 1997 Purchase Plan, or (c) terminate the 1997 Purchase Plan. The Board of Directors may also make provisions for adjusting the number of shares subject to the 1997 Purchase Plan and the purchase price per share if the Company effects one or more reorganizations, recapitalizations, rights offerings or other increases or decreases in the number of shares of the Company's outstanding Common Stock.

Amendment and Termination of the 1997 Purchase Plan

The Board of Directors may at any time amend or terminate the 1997 Purchase Plan; provided, however, amendments that would increase the number of shares reserved for purchase or would otherwise require stockholder approval in order to comply with other regulatory requirements, require stockholder approval.

CERTAIN UNITED STATES FEDERAL INCOME TAX INFORMATION

The 1997 Purchase Plan is intended to qualify under the provisions of Sections 421 and 423 of the Code with respect to participants who are citizens of the United States ("U.S. Participants"). Under these provisions, no income will be taxable to a U.S. Participant at the time of grant of the option or purchase of shares. Upon disposition of the shares, the U.S. Participant will generally be subject to tax, the amount of which will depend upon the holding period. If the shares have been held by the U.S. Participant for more than two years after the offering date and more than one year after the exercise date, the lesser of: (a) the excess of the fair market value of the shares at the time of such disposition over the option price, or (b) the excess of the fair market value of the shares at the time the option was granted over the option price (which option price will be computed as of the grant date) will be treated as ordinary income, and any further gain will be treated as long-term capital gain. If the shares are disposed of before the expiration of these holding periods, the excess of the fair market value of the shares on the exercise date over the option price will be treated as ordinary income, and any further gain or any loss on such disposition will be long-term or short-term capital gain or loss, depending on the holding period. Special rules may apply with respect to U.S. Participants subject to Section 16(b) of the Securities Exchange Act of 1934, as amended. The Company is not entitled to a deduction for amounts taxed as ordinary income or capital gain to a U.S. Participant except to the extent of ordinary income reported by U.S. Participants upon disposition of shares prior to the expiration of the two holding periods described above. The consequences to non-U.S. Participants are governed by foreign laws, which typically do not offer the same tax advantages as U.S. laws.

The foregoing is only a summary of the effect of federal income taxation upon the participant and the Company with respect to the grant and exercise of options under the 1997 Purchase Plan, does not purport to be complete, and does not discuss the income tax laws of any municipality, state or foreign country in which a participant may reside. It is advisable that a participant contact his or her own tax advisor concerning the application of all of these tax laws.

STOCK PRICE

The closing price of a share of the Company's Common Stock on the Nasdaq National Market on September 18, 1998 was \$22.375.

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PLAN BENEFITS

The Company cannot now determine the number of shares to be purchased in the future by the named executive officers, all current executive officers as a group or all employees (excluding executive officers) as a group. In the fiscal year ended June 30, 1998, however, the following shares of Common Stock were purchased by such persons pursuant to the 1997 Purchase Plan and the 1981 Purchase Plan:

NAME OR GROUP -----	NUMBER OF SHARES -----
Kenneth Levy.....	1,122
Jon D. Tompkins.....	617
Kenneth L. Schroeder.....	937
Robert J. Boehlke.....	760
Gary E. Dickerson.....	1,173
Graham J. Siddall.....	617
All current executive officers (13 persons-as a group).....	12,254
All employees (including current officers who are not executive officers).....	802,737

PROPOSAL FOUR

APPROVAL OF THE 1998 OUTSIDE DIRECTOR OPTION PLAN AND RESERVATION OF 1,000,000 SHARES OF COMMON STOCK OF THE COMPANY FOR ISSUANCE THEREUNDER.

GENERAL

The Company's 1998 Outside Director Option Plan (the "1998 Director Plan") was adopted by the Board of Directors in August 1998 and is intended to allow the Company to attract and retain the best available individuals for service as non-employee members of the Board of Directors ("Outside Directors") and to encourage their continued service on the Board. The Company has initially reserved 1,000,000 shares of Common Stock for issuance under the 1998 Director Plan. At the Annual Meeting, the stockholders are being asked to approve the 1998 Director Plan and to approve the reservation of 1,000,000 shares for issuance thereunder. Upon approval by the stockholders of the Company, the Company will no longer grant any options under the current Outside Directors Stock Option Plan and will terminate that plan.

SUMMARY OF THE 1998 DIRECTOR PLAN

The essential features of the 1998 Director Plan are outlined below; provided however, that the following summary is qualified in its entirety by the specific language of the 1998 Director Plan, a copy of which is available at no charge to any stockholder upon request.

Purpose

The 1998 Director Plan provides for the grant of nonstatutory stock options to Outside Directors to allow the Company to attract and retain the best available individuals for service as Outside Directors.

Administration

The 1998 Director Plan may be administered by the Board of Directors or a committee of the Board (as applicable, the "Administrator"). The Administrator has the power to determine the terms of the options granted, including the exercise price of the option, the number of shares subject to each option, the exercisability thereof, and the form of consideration payable upon such exercise. In addition, the Administra-

tor has the authority to amend, suspend or terminate the 1998 Director Plan, provided that no such action may affect any share of Common Stock previously issued and sold or any option previously granted under the 1998 Director Plan.

Eligibility

Options under the 1998 Director Plan may be granted only to Outside Directors. No person has any discretion to select which Outside Directors shall be granted options. In addition to discretionary grants by the Board of Directors, the Director Plan provides for automatic grants of options to be made in the following ways: (a) each Outside Director as of the date on which such director first becomes an Outside Director receives a nonstatutory option to purchase 10,000 shares of Common Stock (the "First Option"); and (b) each Outside Director shall automatically be granted a nonstatutory option to purchase an additional 5,000 shares of Common Stock on the date of the subsequent annual meetings on which he or she remains an Outside Director (the "Subsequent Option").

Terms of Options

Options granted under the 1998 Director Plan are generally not transferable by the optionee, and each option is exercisable during the lifetime of the optionee only by such optionee. Options granted under the 1998 Director Plan must generally be exercised within 30 days after the end of optionee's status as an Outside Director of the Company, or within twelve months after such optionee's termination by death or disability, but in no event later than the expiration of the option's term.

The exercise price of nonstatutory stock options granted under the 1998 Director Plan shall be at least equal to the fair market value of the Common Stock on the date of grant. The term of all options granted under the 1998 Director Plan may not exceed ten years. Both the First Option and the Subsequent Option shall become 100% exercisable on their respective dates of grant.

Amendment or Termination

The Administrator may amend or terminate the 1998 Director Plan at any time. However, no amendment or termination may adversely affect any stock options then outstanding under the 1998 Director Plan without the optionee's consent.

The 1998 Director Plan provides that in the event of a merger of the Company with or into another corporation, or a sale of substantially all of the Company's assets, each option shall be assumed or an equivalent option substituted for by the successor corporation. If the outstanding options are not assumed or substituted for by the successor corporation, the Administrator shall provide for the optionee to have the right to exercise the option as to all of the optioned stock, including shares as to which it would not otherwise be exercisable. If the Administrator makes an option exercisable in full in the event of a merger or sale of substantially all of the Company's assets, the Administrator shall notify the optionee that the option shall be fully exercisable for a period of fifteen (15) days from the date of such notice, and the option will terminate upon the expiration of such period.

CERTAIN UNITED STATES FEDERAL INCOME TAX INFORMATION

The following is only a summary of the effect of federal income taxation upon the Outside Director and the Company with respect to the grant and exercise of options under the 1998 Director Option Plan. This summary does not purport to be complete and does not discuss the income tax laws of any municipality, state or foreign country in which an Outside Director may reside.

Options granted under the 1998 Director Plan are nonstatutory options ("NSO"). An Outside Director will not recognize any taxable income at the time he or she is granted an NSO. However, upon the exercise of an NSO, the optionee will recognize ordinary income measured by the excess of the then fair market value of the shares over the option price. Upon resale of such shares by the Outside Director, any difference between the sale price and the exercise price, to the extent not recognized as ordinary income as provided above, will be

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treated as long-term or short-term capital gain or loss, depending on the holding period. The Company will be entitled to a tax deduction in the same amount as the ordinary income recognized by the Outside Director with respect to shares acquired upon exercise of an NSO.

PLAN BENEFITS

If the 1998 Director Plan is approved at the Annual Meeting, each Outside Director serving on the Board of Directors shall be entitled to each receive a Subsequent Option. If Proposals One and Four are approved by the stockholders, there will be eight Outside Directors on the Board of Directors immediately following the Annual Meeting and options to purchase an aggregate of 40,000 shares of Common Stock will therefore be outstanding under the 1998 Director Plan immediately following the Annual Meeting.

REQUIRED VOTE

The affirmative vote of a majority of the Votes Cast will be required to approve the adoption of the 1998 Director Plan and for the reservation of 1,000,000 shares of Common Stock of the Company for issuance thereunder.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE ADOPTION OF THE 1998 DIRECTOR PLAN AND FOR THE RESERVATION OF 1,000,000 SHARES OF COMMON STOCK OF THE COMPANY FOR ISSUANCE THEREUNDER.

PROPOSAL FIVE

TO RATIFY THE APPOINTMENT OF PRICEWATERHOUSECOOPERS LLP AS THE INDEPENDENT ACCOUNTANTS OF THE COMPANY FOR THE FISCAL YEAR ENDING JUNE 30, 1999.

The Board of Directors has selected PricewaterhouseCoopers LLP, independent accountants, to audit the consolidated financial statements of the Company for its 1999 fiscal year and recommends that the stockholders vote for ratification of such appointment. If there is a negative vote on such ratification, the Board of Directors will reconsider its selection. Representatives of PricewaterhouseCoopers LLP are expected to be present at the Annual Meeting with the opportunity to make a statement if they desire to do so, and are expected to be available to respond to appropriate questions.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE RATIFICATION OF THE APPOINTMENT OF PRICEWATERHOUSECOOPERS LLP AS THE INDEPENDENT ACCOUNTANTS OF THE COMPANY FOR THE FISCAL YEAR ENDING JUNE 30, 1999.

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EXECUTIVE COMPENSATION

The following table shows, as to the person who served as Chief Executive Officer during the fiscal year ended June 30, 1998 and each of the five other most highly compensated executive officers whose salary plus bonus exceeded \$100,000, information concerning all reportable compensation awarded to, earned by or paid to each for services to the Company in all capacities during the fiscal year ended June 30, 1998, as well as such compensation for each such individual for the Company's previous two fiscal years.

SUMMARY COMPENSATION TABLE

NAME AND PRINCIPAL POSITION	YEAR	ANNUAL COMPENSATION			LONG TERM COMPENSATION				
		SALARY \$(1)	BONUS	OTHER ANNUAL COMPEN- SATION \$(1)(1)	AWARDS		SECURITIES UNDERLYING OPTIONS/ SARS\$(1)(3)	PAYOUTS LTIP PAYOUTS \$(1)(4)	ALL OTHER COMPENSATION \$(1)(5)
					RESTRICTED STOCK AWARD\$(1)(2)				
Kenneth Levy(6)	1998	\$467,769	\$262,114	SN/A	-0-	62,500	-0-	\$ 44,410	
Chief Executive Officer	1997	\$402,122	\$114,277	SN/A	-0-	162,500	-0-	\$ 71,158	
Chairman of the Board	1996	\$150,289	\$411,070	SN/A	-0-	-0-	-0-	\$111,021	
Jon D. Tompkins(7)	1998	\$467,769	\$262,114	SN/A	-0-	-0-	-0-	\$ 44,410	
Chairman of the Board	1997	\$189,589	\$196,462	SN/A	-0-	100,000	-0-	\$ 1,500	
Chief Executive Officer	1996(8)	\$152,067	\$281,562	SN/A	-0-	71,999	-0-	\$ 12,291	
Kenneth L. Schroeder	1998	\$455,992	\$256,757	SN/A	-0-	62,500	-0-	\$ 43,545	
President and Chief Operating Officer	1997	\$184,231	\$112,800	SN/A	-0-	162,500	-0-	\$ 71,452	
	1996	\$110,777	\$196,095	SN/A	-0-	-0-	-0-	\$106,810	
Robert J. Boehlke	1998	\$297,115	\$116,708	SN/A	-0-	11,500	-0-	\$ 28,604	
Executive Vice President	1997	\$257,908	\$141,587	SN/A	-0-	71,500	-0-	\$ 49,911	
and Chief Financial Officer	1996	\$248,185	\$186,008	SN/A	-0-	-0-	-0-	\$ 79,526	
Gary E. Dickerson	1998	\$112,115	\$161,164	SN/A	-0-	42,500	-0-	\$ 29,984	
Executive Vice President, Yield Management Solutions	1997	\$260,611	\$129,441	SN/A	-0-	82,500	-0-	\$ 50,197	
	1996	\$221,146	\$172,500	SN/A	-0-	20,000	-0-	\$ 71,104	
Graham J. Siddall(8)	1998	\$112,115	\$ 64,717	SN/A	-0-	-0-	-0-	\$ 29,984	
Executive Vice President, Wafer Inspection Group	1997	\$261,062	\$217,661	SN/A	-0-	40,000	-0-	\$ 1,500	
	1996(8)	\$242,062	\$214,112	SN/A	-0-	87,999	-0-	\$ 1,500	

(1) The amounts paid during the fiscal year to the named executive officers were less than the lesser of (a) \$50,000 or (b) 10% of the executive officers total reported salary and bonus.

(2) The Company has not granted any restricted stock rights.

(3) The Company has not granted any stock appreciation rights.

(4) The Company does not have any Long Term Incentive Plans as that term is defined in the regulations.

(5) "All Other Compensation" is itemized as follows:

- In 1998, Mr. Levy received \$25,496 in cash profit sharing; \$9,246 in profit sharing was contributed by the Company to the 401(k) Plan; \$8,688 was contributed by the Company to the Excess Profit Stock Plan; \$1,000 was contributed by the Company as a matching contribution to the 401(k) Plan.
- In 1998, Mr. Tompkins received \$25,496 in cash profit sharing; \$9,246 in profit sharing was contributed by the Company to the 401(k) Plan; \$8,688 was contributed by the Company to the Excess Profit Stock Plan; \$1,000 was contributed by the Company as a matching contribution to the 401(k) Plan.
- In 1998, Mr. Schroeder received \$25,001 in cash profit sharing; \$9,230 in profit sharing was contributed by the Company to the 401(k) Plan; \$8,314 was contributed by the Company to the Excess Profit Stock Plan; \$1,000 was contributed by the Company as a matching contribution to the 401(k) Plan.
- In 1998, Mr. Boehlke received \$16,205 in cash profit sharing; \$8,681 in profit sharing was contributed by the Company to the 401(k) Plan; \$2,718 was contributed by the Company to the Excess Profit Stock Plan; \$1,000 was contributed by the Company as a matching contribution to the 401(k) Plan.
- In 1998, Mr. Dickerson received \$17,016 in cash profit sharing; \$9,032 in profit sharing was contributed by the Company to the 401(k) Plan; \$2,936 was contributed by the Company to the Excess Profit Stock Plan; \$1,000 was contributed by the Company as a matching contribution to the 401(k) Plan.

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- In 1998, Mr. Siddall received \$17,016 in cash profit sharing; \$9,032 in profit sharing was contributed by the Company to the 401(k) Plan; \$2,936 was contributed by the Company to the Excess Profit Stock Plan; \$1,000 was contributed by the Company as a matching contribution to the 401(k) Plan.
- (6) Mr. Levy was named Chief Executive Officer effective July 1, 1998. During fiscal 1997, Mr. Levy was Chief Executive Officer until April 30, 1997 when, as a result of the merger of Tencor Instruments ("Tencor") into a wholly-owned subsidiary of the Company (the "Merger"), he became Chairman of the Board of Directors and remained in that position until July 1, 1998.
- (7) Mr. Tompkins was named Chairman of the Board effective July 1, 1998. He was previously President and Chief Executive Officer of Tencor until April 1997. As a result of the Merger he became Chief Executive Officer of the Company effective April 30, 1997 and remained in that position until July 1, 1998. The compensation described in this Summary Compensation Table reflects certain amounts which were paid during the period prior to the Merger when Tencor was an independent, publicly traded company. Tencor reported its results on a calendar year basis, while the Company reports its results based on a June 30 year end.
- (8) The amounts reported for 1996 for Mr. Tompkins and Mr. Siddall are those amounts reported by Tencor in its proxy statements filed with the Securities and Exchange Commission for the year ended December 31, 1996.

STOCK OPTION GRANTS AND EXERCISES

The following tables set forth the stock options granted to the named executive officers under the Company's stock option plans and the options exercised by such named executive officers during the fiscal year ended June 30, 1998.

The Option/SAR Grant Table sets forth hypothetical gains or "option spreads" for the options at the end of their respective ten-year terms, as calculated in accordance with the rules of the Securities and Exchange Commission. Each gain is based on an arbitrarily assumed annualized rate of compound appreciation of the market price at the date of grant of 5% and 10% from the date the option was granted to the end of the option term. Actual gains, if any, on option exercises are dependent on the future performance of the Company's Common Stock and overall market conditions.

OPTION/SAR(1) GRANTS IN LAST FISCAL YEAR

KLA-TENCOR CORPORATION 1982 STOCK OPTION PLAN(2)

INDIVIDUAL GRANTS							
NAME	OPTIONS/SARS GRANTED (#)	PERCENT OF TOTAL OPTIONS/SARS GRANTED TO EMPLOYEES IN FISCAL YEAR	EXERCISE OR BASE PRICE (\$/SHARE)	EXPIRATION DATE	POTENTIAL REALIZABLE VALUE ASSUMED ANNUAL RATES OF STOCK PRICE APPRECIATION FOR OPTION TERM		
					5%	10%	
Kenneth Levy.....	62,500	1.73%	\$60.5625	07/31/07	\$2,380,464	\$6,032,564	
Jon D. Tompkins.....	-0-	-0-	-0-	N/A	-0-	-0-	
Kenneth L. Schroeder....	62,500	1.73%	\$60.5625	07/31/07	\$2,180,464	\$6,032,564	
Robert J. Boehlke.....	19,500	.93%	\$60.5625	07/31/07	\$1,275,929	\$3,233,454	
Gary E. Dickerson.....	42,500	1.18%	\$60.5625	07/31/07	\$1,618,716	\$4,102,144	
Graham J. Siddall.....	-0-	-0-	-0-	N/A	-0-	-0-	

(1) The Company has not granted any stock appreciation rights.

(2) The material terms of the grants (other than those set forth in the table) are: (a) The exercise price of the options is the fair market value of Common Stock as of the date of grant; (b) The options vest on a four year schedule with 25% after one year and the remaining option shares vesting 1/36th per month for the remainder of the vesting term; (c) To the extent unexercised, the options lapse after ten years; (d) The options are non-transferrable and are only exercisable during the period of employment of the

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optionee and for 30 days following termination of employment, subject to limited exceptions in the cases of certain terminations, death or permanent disability of the optionee.

AGGREGATED OPTION/SAR EXERCISES IN LAST FISCAL YEAR AND YEAR-END VALUE(1)

KLA-TENCOR CORPORATION 1982 STOCK OPTION PLAN

NAME -----	NUMBER OF SHARES ACQUIRED ON EXERCISE -----	VALUE REALIZED -----	TOTAL NUMBER OF UNEXERCISED OPTIONS HELD AT FISCAL YEAR END -----		TOTAL VALUE(2) OF UNEXERCISED, IN-THE-MONEY OPTIONS HELD AT FISCAL YEAR END -----	
			EXERCISABLE	UNEXERCISABLE	EXERCISABLE	UNEXERCISABLE
Kenneth Levy.....	-0-	-0-	326,901	226,099	\$5,673,025	\$800,006
Jon D. Tompkins.....	-0-	-0-	15,000	85,000	-0-	-0-
Kenneth L. Schroeder.....	20,000	\$1,283,750	298,901	226,099	\$4,958,276	\$800,006
Robert J. Boehlke.....	35,000	\$1,965,880	80,604	104,208	\$ 524,526	\$495,548
Gary E. Dickerson.....	26,500	\$1,379,228	71,815	128,885	\$ 316,089	\$446,517
Graham J. Siddall(3).....	-0-	-0-	18,437	21,563	-0-	-0-

(1) The Company has not granted any stock appreciation rights.

(2) Total value of vested options based on fair market value of Company's Common Stock of \$27.6875 per share as of June 30, 1998.

AGGREGATED OPTION/SAR EXERCISES IN LAST FISCAL YEAR AND YEAR-END VALUE(1)

TENCOR INSTRUMENTS 1993 EQUITY INCENTIVE PLAN

NAME -----	NUMBER OF SHARES ACQUIRED ON EXERCISE -----	VALUE REALIZED -----	TOTAL NUMBER OF UNEXERCISED OPTIONS HELD AT FISCAL YEAR END -----		TOTAL VALUE(2) OF UNEXERCISED, IN-THE-MONEY OPTIONS HELD AT FISCAL YEAR END -----	
			EXERCISABLE	UNEXERCISABLE	EXERCISABLE	UNEXERCISABLE
Kenneth Levy(3).....	-0-	-0-	-0-	-0-	-0-	-0-
Jon D. Tompkins.....	103,172	\$5,753,834	70,947	61,003	\$ 870,737	\$721,660
Kenneth L. Schroeder(3).....	-0-	-0-	-0-	-0-	-0-	-0-
Robert J. Boehlke(3)...	-0-	-0-	-0-	-0-	-0-	-0-
Gary E. Dickerson(3)...	-0-	-0-	-0-	-0-	-0-	-0-
Graham J. Siddall.....	17,050	\$ 922,255	105,447	49,625	\$1,619,674	\$523,601

(1) The Company has not granted any stock appreciation rights.

(2) Total value of vested options based on fair market value of Company's Common Stock of \$27.6875 per share as of June 30, 1998.

(3) Messrs. Levy, Schroeder, Boehlke and Dickerson have been executive officers of the Company and accordingly have never received options under the Tencor Instruments 1993 Equity Incentive Plan. Accordingly, the information under this table is inapplicable to them.

REPORT OF THE COMPENSATION COMMITTEE ON EXECUTIVE COMPENSATION

Compensation Committee

The Committee is comprised of three of the independent, non-employee members of the Board of Directors, none of whom have interlocking relationships as defined by the Securities and Exchange Commission. The Committee is responsible for setting and administering the policies governing annual compensation of executive officers, considers their performance and makes recommendations regarding their cash compensation and stock options to the full Board of Directors. The Committee periodically reviews its approach to executive compensation and makes changes as appropriate.

Compensation Philosophy

The Committee of the Board of Directors establishes the overall executive compensation strategies of the Company and approves compensation elements for the chairman of the board, the chief executive officer and other executive officers. The goals of the Company's compensation policy are to attract, retain and reward executive officers who contribute to the overall success of the Company by offering compensation that is competitive in the industry, to motivate executive officers to achieve the Company's business objectives and to align the interests of executive officers with the long term interests of stockholders. The Company currently uses salary, a management incentive plan and stock options to meet these goals.

The compensation philosophy of the Committee is to provide a comprehensive compensation package for each executive officer that is well suited to support accomplishment of the Company's business strategies, objectives and initiatives. For incentive-based compensation, the Committee considers the desirability of structuring such compensation arrangements so as to qualify for deductibility under Section 162(m) of the Internal Revenue Code. As the Committee applies this compensation philosophy in determining appropriate executive compensation levels and other compensation factors, the Committee reaches its decisions with a view towards the Company's overall financial performance.

Executive Officer Compensation

The Committee's approach is based upon a belief that a substantial portion of aggregate annual compensation for executive officers should be contingent upon the Company's performance and an individual's contribution to the Company's success. In addition, the Committee strives to align the interests of the Company's executive officers with the long-term interests of stockholders through stock option grants that can result in ownership of the Company's Common Stock. The Committee endeavors to structure each executive officer's overall compensation package to be consistent with this approach and to enable the Company to attract, retain and reward personnel who contribute to the success of the Company.

The Company provides its executive officers with a compensation package consisting of base salary, variable incentive pay and participation in benefit plans generally available to other employees. The Committee considers market information from published survey data provided to the Committee by the Company's human resources staff. The market data consists primarily of base salary and total cash compensation rates, as well as incentive bonus and stock programs of other companies considered by the Committee to be peers in the Company's industry.

For the Company's previous fiscal year, the Committee reviewed and recommended a compensation structure which had as an important component, the successful integration of KLA Instruments Corporation and Tencor Instruments. The merger was completed April 30, 1997 with the Company's fiscal 1998 year focused on integrating the two companies as well as substantial economic and business challenges in the semiconductor and semiconductor capital equipment industries worldwide.

Base Salary. Salaries for executive officers are set with reference to salaries for comparable positions among other companies in the Company's industry or in industries that employ individuals of similar education and background to the executive officer based on data provided by the Company's human resources staff.

Management Incentive Plan. Each year since fiscal 1979, the Company has adopted a management incentive plan (the "Incentive Plan") which provides for payments to officers and key employees based on the financial performance of the Company or the relevant business unit, and on the achievement of the person's individual performance objectives. The Incentive Plan is approved by the Committee and submitted to the Board of Directors for ratification. For fiscal 1999 the Incentive Plan sets goals for profitability, achievement of measurable objectives aimed at strategic corporate goals and achievement of objectives relating to managing the ratio of assets to sales.

Outstanding Corporate Performance Executive Bonus Plan. The Company adopted an additional incentive plan (the "Outstanding Corporate Performance Plan") which allows for an additional bonus in years when the Company achieves certain levels of profitability and growth. For those executive officers that do not have operating divisions reporting to them, the matrix is based on the Company's pre-tax margin and the growth of the Company compared to a peer group. The target percentage for the Outstanding Corporate Performance Plan is the same target percentage as utilized in determining the Incentive Plan bonus. For those executive officers who do have operating divisions reporting to them, the matrix is based on certain specified growth objectives for that division and the Company's net operating margin. The target percentage for the Outstanding Corporate Performance Plan is also the same as that utilized in determining the Incentive Plan bonus. Any amounts to be paid under the Outstanding Corporate Performance Plan will be in the form of a contribution by the Company to the Executive Deferred Savings Plan (the "EDSP") and will vest over a one year period. At the end of such one year period, the executive officer will have the choice of taking a cash payment or leaving it in the EDSP. If the executive officer should leave during that one year period, the contribution by the Company shall be forfeited. The executive officer will be eligible to participate in the Company's profit sharing plan while eligible for Company contributions under the Outstanding Corporate Performance Plan but any amounts contributed by the Company pursuant to the Outstanding Corporate Performance Plan will be offset by profit sharing paid during the year.

Long-term Incentives. Longer term incentives are provided through the Stock Option Plan and the Excess Profit Stock Plan, each of which reward executive officers through the growth in value of the Company's Common Stock. The Committee believes that employee equity ownership is highly motivating, provides a major incentive for employees to build stockholder value and serves to align the interests of employees with those of stockholders.

Grants of stock options to executive officers are based upon each executive officer's relative position, responsibilities, historical and expected contributions to the Company, and the executive officer's existing stock ownership and previous option grants, with primary weight given to the executive officer's relative rank and responsibilities. Stock options are granted at market price on the date of grant and will provide value to the executive officers only when the price of the Company's Common Stock increases over the exercise price.

Approval of Fiscal Year 1999 Bonus Plan and Outstanding Corporate Performance Plan

The Committee approved the fiscal year 1999 bonus plan incentive formula which is based on two components of equal weight. The first is performance against certain financial objectives and the second is achievement of certain non-financial strategic objectives. The bonuses for the Chairman of the Board, the Chief Executive Officer, the President/Chief Operating Officer and the Chief Financial Officer are based on an average of the performance of those managers reporting to the executive officers utilizing a combination of the weighted average contribution made by each manager and a simple average of those contributions. The Committee also approved the fiscal year Outstanding Corporate Performance Plan which is based on a matrix of the Company's net operating margin and certain growth objectives. The Outstanding Corporate Performance Plan does not require any contributions by the Company until the Company achieves a Pre-Tax Margin Factor of 14%. The Pre-Tax Margin Factor is calculated by taking the pre-tax, pre-profit sharing income, excluding non-recurring charges, and dividing it by total revenue.

Chief Executive Officer Compensation

For fiscal year 1998, Jon D. Tompkins served as Chief Executive Officer and Kenneth Levy served as Chairman of the Board. Effective July 1, 1998 Mr. Tompkins assumed the role of Chairman of the Board and Mr. Levy assumed the role of Chief Executive Officer. Base salary for Mr. Tompkins for fiscal 1999 has been set at \$245,440, and the base salary for Mr. Levy has been set at \$490,880 based on the recommendations provided by the Company's Human Resources Compensation staff. Options to purchase 50,809 shares of the Common Stock of the Company were granted to Mr. Tompkins and options to purchase 102,136 shares of the Common Stock of the Company were granted to Mr. Levy, each with standard four year vesting terms. For fiscal 1998 a bonus of \$262,314 was paid to Mr. Levy and a bonus of \$262,314 was paid to Mr. Tompkins. These payments were based on the formula approved by the Compensation Committee and the Board of Directors last year. In a year in which the Company faced many challenges, including the integration of two companies and severe economic downturn in the semiconductor and semiconductor capital equipment industries worldwide, the Company successfully integrated two companies and continued its profitability with revenues of \$1.2 billion and earnings per share of \$1.76.

MEMBERS OF THE COMPENSATION COMMITTEE

James W. Bagley
Leo J. Chamberlain
Lida Urbanek

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COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The members of the Compensation Committee are set forth in the preceding section. There are no members of the Compensation Committee who were officers or employees of the Company or any of its subsidiaries during the fiscal year, formerly officers of the Company, or had any relationship otherwise requiring disclosure hereunder.

PERFORMANCE GRAPH

The stock price performance shown on the graph following is not necessarily indicative of future price performance.

COMPARISON OF FIVE YEAR CUMULATIVE TOTAL RETURN AMONG KLA-TENCOR CORPORATION, THE NASDAQ -- US INDEX AND THE HAMBRECHT & QUIST TECHNOLOGY INDEX*

	KLA-TENCOR CORPORATION	NASDAQ - US INDEX	HAMBRECHT & QUIST TECHNOLOGY INDEX
6/30/93	100.00	100.00	100.00
6/30/94	217.39	100.96	102.21
6/30/95	447.83	134.77	180.82
6/30/96	269.57	173.03	211.32
6/30/97	565.22	210.38	275.98
6/30/98	321.01	277.69	349.59

* Assumes \$100 invested on June 30, 1993. The Company's fiscal year end is June 30.

CERTAIN TRANSACTIONS

In connection with the merger between KLA Instruments Corporation and Tencor Instruments (effective April 30, 1997) the Company entered into identical employment arrangements, subsequently amended, with Kenneth Levy, Jon D. Tompkins and Kenneth L. Schroeder, all executive officers of the Company. The arrangements, as amended, provide that certain benefits would be paid if certain events took place after April 30, 1997. The purpose of these arrangements is to retain the services of Messrs. Levy, Tompkins and Schroeder to ensure the continued smooth transition associated with the Merger. The terms of those arrangements provide that if an individual were to leave the Company after April 30, 1998, subject to releasing the Company from all claims, and in connection with working part-time for 36 months, he will receive (i) his base salary for the first 24 months of part-time employment, (ii) a mutually agreeable level of compensation per month for the final 12 months of part-time employment, (iii) an annual bonus (based on an achievement of 100% of bonus objectives) in the fiscal year of his transition to part-time employment, (iv) a bonus paid in the fiscal year following the payment of the annual bonus above, (based on achievement of 100% of his individual bonus objectives) and (v) a pro-rated bonus for the fiscal year in which part-time employment ended. During the periods of part-time employment, all options to exercise stock of the Company which were granted more than 12 months prior to the termination of full-time employment will continue to vest. The same benefits shall be payable in the event the Company terminates his employment without cause. If he is terminated for cause (defined as (i) gross negligence or willful misconduct in connection with the performance of duties, (ii) conviction of or plea of nolo contendere to any felony, or (iii) the embezzlement or misappropriation of Company property) then he will receive a lump-sum payment equal to 25% of his base salary.

COMPLIANCE WITH SECTION 16(a) OF THE SECURITIES EXCHANGE ACT OF 1934

Section 16(a) of the Exchange Act requires the Company's executive officers, directors, and persons who own more than ten percent of a registered class of the Company's equity securities to file reports of ownership and changes in ownership with the SEC. Executive officers, directors and greater than ten percent stockholders are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file. Kenneth Levy, an executive officer and director of the Company filed an amendment to his Form 4 for the month ending August 30, 1997 in order to reflect transactions by a family member and a family trust, which had inadvertently been left off of the original Form 4. Mr. Levy filed the amendment when he discovered the error. Jon D. Tompkins, an executive officer and director of the Company filed an amendment to his Form 4 for the month ending July 31, 1997 to reflect ownership of an additional 1,500 shares of the Company's Common Stock owned by Mr. Tompkins. These shares were inadvertently not reported on the original Form 4 because they were held by Mr. Tompkins under the Tencor Instruments employee stock purchase plan prior to the Merger. Mr. Tompkins filed an amendment when he discovered the error. Dean O. Morton, a director of the Company, filed an amended Form 4 for the month ending August 30, 1997 to reflect an exercise of a stock option inadvertently not reported on the original Form 4. Mr. Morton filed an amendment when he discovered the error. Graham J. Siddall, an executive officer of the Company filed an amendment to his Form 4 for the month ending August 30, 1997 in order to reflect exercises of stock options which had inadvertently been left off the original Form 4. Mr. Siddall filed the amendment when he discovered the error.

OTHER MATTERS

The Company knows of no other matters to be submitted to the stockholders at the Annual Meeting. If any other matters properly come before the Annual Meeting, it is the intention of the persons named in the enclosed form of Proxy to vote the shares they represent as the Board of Directors may recommend.

THE BOARD OF DIRECTORS

September 30, 1998

KLA-TENCOR CORPORATION

1998 OUTSIDE DIRECTOR OPTION PLAN

1. Purposes of the Plan. The purposes of this 1998 Outside Director Option Plan are to attract and retain the best available personnel for service as Outside Directors (as defined herein) of the Company, to provide additional incentive to the Outside Directors of the Company to serve as Directors, and to encourage their continued service on the Board.

All options granted hereunder shall be nonstatutory stock options.

2. Definitions. As used herein, the following definitions shall apply:

(a) "Board" means the Board of Directors of the Company.

(b) "Code" means the Internal Revenue Code of 1986, as amended.

(c) "Common Stock" means the common stock of the Company.

(d) "Company" means KLA-Tencor Corporation.

(e) "Director" means a member of the Board.

(f) "Disability" means total and permanent disability as defined in section 22(e)(3) of the Code.

(g) "Employee" means any person, including officers and Directors, employed by the Company or any Parent or Subsidiary of the Company. The payment of a Director's fee by the Company shall not be sufficient in and of itself to constitute "employment" by the Company.

(h) "Exchange Act" means the Securities Exchange Act of 1934, as amended.

(i) "Fair Market Value" means, as of any date, the value of Common Stock determined as follows:

(i) If the Common Stock is listed on any established stock exchange or a national market system, including without limitation the Nasdaq National Market or The Nasdaq SmallCap Market of The Nasdaq Stock Market, its Fair Market Value shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such exchange or system on the date of determination as reported in The Wall Street Journal or such other source as the Administrator deems reliable;

(ii) If the Common Stock is regularly quoted by a recognized securities dealer but selling prices are not reported, the Fair Market Value of a Share of Common Stock shall be the mean between the high bid and low asked prices for the Common Stock on the date of determination, as reported in The Wall Street Journal or such other source as the Board deems reliable; or

(iii) In the absence of an established market for the Common Stock, the Fair Market Value thereof shall be determined in good faith by the Board.

(j) "Inside Director" means a Director who is an Employee.

(k) "Option" means a stock option granted pursuant to the Plan.

(l) "Optioned Stock" means the Common Stock subject to an Option.

(m) "Optionee" means a Director who holds an Option.

(n) "Outside Director" means a Director who is not an Employee.

(o) "Parent" means a "parent corporation," whether now or hereafter existing, as defined in Section 424(e) of the Code.

(p) "Plan" means this 1998 Director Option Plan.

(q) "Share" means a share of the Common Stock, as adjusted in accordance with Section 10 of the Plan.

(r) "Subsidiary" means a "subsidiary corporation," whether now or hereafter existing, as defined in Section 424(f) of the Code.

3. Stock Subject to the Plan. Subject to the provisions of Section 10 of the Plan, the maximum aggregate number of Shares which may be optioned and sold under the Plan is one million Shares (the "Pool"). The Shares may be authorized, but unissued, or reacquired Common Stock.

If an Option expires or becomes unexercisable without having been exercised in full, the unpurchased Shares which were subject thereto shall become available for future grant or sale under the Plan (unless the Plan has terminated). Shares that have actually been issued under the Plan shall not be returned to the Plan and shall not become available for future distribution under the Plan.

4. Administration and Grants of Options under the Plan.

(a) Discretionary Grants. The Board (or its committee) shall have the authority, in its discretion, to make discretionary grants of Options hereunder to Outside Directors and to specify the terms and conditions of such discretionary Option grants.

(b) Automatic Grants. Outside Directors under this Plan shall receive automatic Option grants as follows:

(i) Each Outside Director shall be automatically granted an Option to purchase ten thousand (10,000) Shares (the "First Option") on the date on which such person first becomes an Outside Director, whether through election by the shareholders of the Company or appointment by the Board to fill a vacancy; provided, however, that an Inside Director who ceases to be an Inside Director but who remains a Director shall not receive a First Option.

(ii) Each Outside Director shall be automatically granted an Option to purchase five thousand (5,000) Shares (a "Subsequent Option") on the day of the Company's annual meeting of shareholders of each year provided he or she is then an Outside Director, and if as of such date, he or she shall have served on the Board for at least the preceding six (6) months.

(iii) The terms of a First Option granted hereunder shall be as follows:

(A) the term of the First Option shall be ten (10) years.

(B) the First Option shall be exercisable only while the Outside Director remains a Director of the Company, except as set forth in Sections 8 and 10 hereof.

(C) the exercise price per Share shall be 100% of the Fair Market Value per Share on the date of grant of the First Option.

(D) subject to Section 10 hereof, the First Option shall become exercisable as to twenty-five percent of the Shares subject to the First Option on the first anniversary of its date of grant and as to 1/48th of the Shares initially subject to the First Option each month thereafter, so as to be 100% vested on the fourth anniversary of the date of grant, provided that the Optionee continues to serve as a Director on such dates.

(iv) The terms of a Subsequent Option granted hereunder shall be as follows:

(A) the term of the Subsequent Option shall be ten (10) years.

(B) the Subsequent Option shall be exercisable only while the Outside Director remains a Director of the Company, except as set forth in Sections 8 and 10 hereof.

(C) the exercise price per Share shall be 100% of the Fair Market Value per Share on the date of grant of the Subsequent Option.

(D) subject to Section 10 hereof, the Subsequent Option shall become exercisable as to 100% percent of the Shares subject to the Subsequent Option on the fourth anniversary of its date of grant, provided that the Optionee continues to serve as a Director on such date.

(c) Powers of the Board. Subject to the provisions of the Plan and, in the case of a committee, the specific duties delegated by the Board to such committee, and subject to the approval of any relevant authorities, the Board (or its committee) shall have the authority, in its discretion:

(i) to modify or amend each Option, including the discretionary authority to change prospectively the vesting schedules of options, to extend the post-termination exercisability period of outstanding Options longer than is otherwise provided for and/or to accelerate the vesting of any outstanding Option;

(ii) to construe and interpret the terms of the Plan and awards granted pursuant to the Plan.

(d) Share Shortfalls. In the event that any Option granted under the Plan would cause the number of Shares subject to outstanding Options plus the number of Shares previously purchased under Options to exceed the Pool, then the remaining Shares available for Option grant shall be granted under Options to the Outside Directors on a pro rata basis. No further grants shall be made until such time, if any, as additional Shares become available for grant under the Plan through action of the Board or the shareholders to increase the number of Shares which may be issued under the Plan or through cancellation or expiration of Options previously granted hereunder.

5. Eligibility. Options may be granted only to Outside Directors. The Plan shall not confer upon any Optionee any right with respect to continuation of service as a Director or nomination to serve as a Director, nor shall it interfere in any way with any rights which the Director or the Company may have to terminate the Director's relationship with the Company at any time.

6. Term of Plan. The Plan shall become effective upon the date upon which it is approved by the Company's stockholders. It shall continue in effect until it is terminated under Section 11 of the Plan.

7. Form of Consideration. The consideration to be paid for the Shares to be issued upon exercise of an Option, including the method of payment, shall consist of (i) cash, (ii) check, (iii) other shares which (x) in the case of Shares acquired upon exercise of an option, have been owned by the Optionee for more than six (6) months on the date of surrender, and (y) have a Fair

Market Value on the date of surrender equal to the aggregate exercise price of the Shares as to which said Option shall be exercised, (iv) consideration received by the Company under a cashless exercise program implemented by the Company in connection with the Plan, or (v) any combination of the foregoing methods of payment.

8. Exercise of Option.

(a) Procedure for Exercise; Rights as a Shareholder. Any Option granted hereunder shall be exercisable at such times as are set forth in Section 4 hereof.

An Option may not be exercised for a fraction of a Share.

An Option shall be deemed to be exercised when written notice of such exercise has been given to the Company in accordance with the terms of the Option by the person entitled to exercise the Option and full payment for the Shares with respect to which the Option is exercised has been received by the Company. Full payment may consist of any consideration and method of payment allowable under Section 7 of the Plan. Until the issuance (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company) of the stock certificate evidencing such Shares, no right to vote or receive dividends or any other rights as a shareholder shall exist with respect to the Optioned Stock, notwithstanding the exercise of the Option. A share certificate for the number of Shares so acquired shall be issued to the Optionee as soon as practicable after exercise of the Option. No adjustment shall be made for a dividend or other right for which the record date is prior to the date the stock certificate is issued, except as provided in Section 10 of the Plan.

Exercise of an Option in any manner shall result in a decrease in the number of Shares which thereafter may be available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised.

(b) Termination of Continuous Status as a Director. Subject to Section 10 hereof, in the event an Optionee's status as a Director terminates (other than upon the Optionee's death or Disability), the Optionee may exercise his or her Option, but only within thirty days (30) following the date of such termination, and only to the extent that the Optionee was entitled to exercise it on the date of such termination (but in no event later than the expiration of its ten (10) year term). To the extent that the Optionee was not entitled to exercise an Option on the date of such termination, and to the extent that the Optionee does not exercise such Option (to the extent otherwise so entitled) within the time specified herein, the Option shall terminate.

(c) Disability of Optionee. In the event Optionee's status as a Director terminates as a result of Disability, the Optionee may exercise his or her Option, but only within twelve (12) months following the date of such termination, and only to the extent that the Optionee was entitled to exercise it on the date of such termination (but in no event later than the expiration of its ten (10) year term). To the extent that the Optionee was not entitled to exercise an Option on the date of termination, or if he or she does not exercise such Option (to the extent otherwise so entitled) within the time specified herein, the Option shall terminate.

(d) Death of Optionee. In the event of an Optionee's death, the Optionee's estate or a person who acquired the right to exercise the Option by bequest or inheritance may exercise the Option, but only within twelve (12) months following the date of death, and only to the extent that the Optionee was entitled to exercise it on the date of death (but in no event later than the expiration of its ten (10) year term). To the extent that the Optionee was not entitled to exercise an Option on the date of death, and to the extent that the Optionee's estate or a person who acquired the right to exercise such Option does not exercise such Option (to the extent otherwise so entitled) within the time specified herein, the Option shall terminate.

9. Non-Transferability of Options. The Option may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the Optionee, only by the Optionee.

10. Adjustments Upon Changes in Capitalization, Dissolution, Merger or Asset Sale.

(a) Changes in Capitalization. Subject to any required action by the shareholders of the Company, the number of Shares covered by each outstanding Option, the number of Shares which have been authorized for issuance under the Plan but as to which no Options have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Option, as well as the price per Share covered by each such outstanding Option, (but not the number of Shares issuable pursuant to the automatic grant provisions of Section 4 hereof) shall be proportionately adjusted for any increase or decrease in the number of issued Shares resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock, or any other increase or decrease in the number of issued Shares effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of Shares subject to an Option.

(b) Dissolution or Liquidation. In the event of the proposed dissolution or liquidation of the Company, to the extent that an Option has not been previously exercised, it shall terminate immediately prior to the consummation of such proposed action.

(c) Merger or Asset Sale. In the event of a merger of the Company with or into another corporation or the sale of substantially all of the assets of the Company, outstanding Options may be assumed or equivalent options may be substituted by the successor corporation or a Parent or Subsidiary thereof (the "Successor Corporation"). If an Option is assumed or substituted for, the Option or equivalent option shall continue to be exercisable as provided in Section 4 hereof for so long as the Optionee serves as a Director or a director of the Successor Corporation. Following such assumption or substitution, if the Optionee's status as a Director or director of the Successor Corporation, as applicable, is terminated other than upon a voluntary

resignation by the Optionee, the Option or option shall become fully exercisable, including as to Shares for which it would not otherwise be exercisable. Thereafter, the Option or option shall remain exercisable in accordance with Sections 8(b) through (d) above.

If the Successor Corporation does not assume an outstanding Option or substitute for it an equivalent option, the Option shall become fully vested and exercisable, including as to Shares for which it would not otherwise be exercisable. In such event the Board shall notify the Optionee that the Option shall be fully exercisable for a period of thirty (30) days from the date of such notice, and upon the expiration of such period the Option shall terminate.

For the purposes of this Section 10(c), an Option shall be considered assumed if, following the merger or sale of assets, the Option confers the right to purchase or receive, for each Share of Optioned Stock subject to the Option immediately prior to the merger or sale of assets, the consideration (whether stock, cash, or other securities or property) received in the merger or sale of assets by holders of Common Stock for each Share held on the effective date of the transaction (and if holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding Shares). If such consideration received in the merger or sale of assets is not solely common stock of the successor corporation or its Parent, the Administrator may, with the consent of the successor corporation, provide for the consideration to be received upon the exercise of the Option, for each Share of Optioned Stock subject to the Option, to be solely common stock of the successor corporation or its Parent equal in fair market value to the per share consideration received by holders of Common Stock in the merger or sale of assets.

11. Amendment and Termination of the Plan.

(a) Amendment and Termination. The Board may at any time amend, alter, suspend, or discontinue the Plan, but no amendment, alteration, suspension, or discontinuation shall be made which would impair the rights of any Optionee under any grant theretofore made, without his or her consent. In addition, to the extent necessary and desirable to comply with any applicable law, regulation or stock exchange rule, the Company shall obtain shareholder approval of any Plan amendment in such a manner and to such a degree as required.

(b) Effect of Amendment or Termination. Any such amendment or termination of the Plan shall not affect Options already granted and such Options shall remain in full force and effect as if this Plan had not been amended or terminated.

12. Time of Granting Options. The date of grant of an Option shall, for all purposes, be the date determined in accordance with Section 4 hereof.

13. Conditions Upon Issuance of Shares. Shares shall not be issued pursuant to the exercise of an Option unless the exercise of such Option and the issuance and delivery of such Shares pursuant thereto shall comply with all relevant provisions of law, including, without limitation, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, state securities laws, and the requirements of any stock exchange upon

which the Shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

As a condition to the exercise of an Option, the Company may require the person exercising such Option to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares, if, in the opinion of counsel for the Company, such a representation is required by any of the aforementioned relevant provisions of law.

Inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

14. Reservation of Shares. The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.

15. Option Agreement. Options shall be evidenced by written option agreements in such form as the Board shall approve.

16. Shareholder Approval. The Plan shall be subject to approval by the shareholders of the Company within twelve (12) months after the date the Plan is adopted. Such shareholder approval shall be obtained in the degree and manner required under applicable state and federal law and any stock exchange rules.

KLA-TENCOR CORPORATION

Proxy for 1998 Annual Meeting of Stockholders

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned, revoking all prior proxies, hereby appoints Kenneth Levy and Lisa C. Berry, and each of them, as Proxies with full power of substitution, to represent and vote as designated in this proxy any and all shares of the common stock of KLA-Tencor Corporation (the "Company"), held or owned by or standing in the name of the undersigned on the Company's books on September 18, 1998, at the Annual Meeting of Stockholders of the Company to be held at the Company's offices at One Technology Drive, Milpitas, California 95035, at 11:00 a.m. local time on Tuesday, November 17, 1998 and any continuation or adjournment thereof, with all powers the undersigned would possess if personally present at the meeting.

The undersigned hereby directs and authorizes said Proxies and each of them, or their substitute or substitutes, to vote as specified with respect to the proposals listed on the reverse side or, if no specification is made, to vote in favor thereof.

The undersigned hereby further confers upon said Proxies, and each of them, or their substitute or substitutes, discretionary authority to vote with respect to all other matters that may properly come before the meeting or any continuation or adjournment thereof.

The undersigned hereby acknowledges receipt of: (a) Notice of Annual Meeting of Stockholders of the Company, (b) accompanying Proxy Statement, and (c) Annual Report to Stockholders for the year ending June 30, 1998.

CONTINUED AND TO BE SIGNED ON REVERSE SIDE

SEE REVERSE SIDE

35
/ X / Please mark votes as in this example.

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS OF THE COMPANY. THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE NOMINEES FOR DIRECTOR AND FOR PROPOSALS 2, 3, 4 AND 5.

1. To elect Class III directors to serve for a three year term and until their successors are elected. Nominees: James W. Bagley, Edward W. Barnholt, Dean O. Morton and Kenneth L. Schroeder.

FOR	WITHHELD
/ /	/ /
/ /	

For all nominees, except as noted above.

2. To approve amendments to the 1997 Employee Stock Purchase Plan to increase the number of shares of Common Stock of the Company reserved for issuance thereunder by 1,000,000 shares.

FOR	AGAINST	ABSTAIN
/ /	/ /	/ /

3. To approve amendments to the 1997 Employee Stock Purchase Plan to increase the number of shares of Common Stock of the Company reserved for issuance thereunder on the first day of each subsequent fiscal year by the lesser of (a) 2,000,000 shares or (b) the number of shares which the Company estimates (based on the previous 12-month period) it will be required to issue under the 1997 Employee Stock Purchase Plan during the forthcoming fiscal year.

FOR	AGAINST	ABSTAIN
/ /	/ /	/ /

4. To approve the 1998 Outside Director Option Plan and to reserve for issuance thereunder 1,000,000 shares of the Common Stock of the Company.

FOR	AGAINST	ABSTAIN
/ /	/ /	/ /

5. To ratify the appointment of PricewaterhouseCoopers LLP as independent accountants of the Company for the fiscal year ending June 30, 1999.

FOR	AGAINST	ABSTAIN
/ /	/ /	/ /

In their discretion, the proxy holders are authorized to vote on all such other matters as may properly come before the meeting or any adjournment thereof.

/ / Mark here if you plan to attend the meeting

/ / Mark here for address change and note below

Please sign exactly as your name appears on your stock certificate(s), date and return this Proxy promptly in the reply envelope provided. Please correct your address before returning this Proxy. Persons signing in a fiduciary capacity should so indicate. If shares are held by joint tenants or as community property, both should sign.

Signature: _____	Date: _____
Signature: _____	Date: _____

[DETACH HERE]

EXHIBIT 6

SCHEDULE 14A INFORMATION
Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934

Filed by the Registrant ☒

Filed by a Party other than the Registrant ☐

Check the appropriate box:

- ☐ Preliminary Proxy Statement
☐ Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
☒ Definitive Proxy Statement
☐ Definitive Additional Materials
☐ Soliciting Material Pursuant to §240.14a-12

KLA – TENCOR CORPORATION

(Name of Registrant as Specified in its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- ☒ No fee required.
☐ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

☐ Fee paid previously with preliminary materials.

☐ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:



NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
October 18, 2004

To the Stockholders:

YOUR VOTE IS IMPORTANT

NOTICE IS HEREBY GIVEN that the Annual Meeting of Stockholders of KLA-Tencor Corporation (the "Company"), a Delaware corporation, will be held on Monday, October 18, 2004 at 1:00 p.m., local time, at the Company's offices located at Three Technology Drive, Milpitas, California 95035, for the following purposes:

1. To elect three Class III directors to each serve for a three-year term and until their successors are duly elected.
2. To approve the Company's 2004 Equity Incentive Plan, including approval of its material terms and performance goals for purposes of Internal Revenue Code Section 162(m).
3. To ratify the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the fiscal year ending June 30, 2005.
4. To transact such other business as may properly come before the Annual Meeting or any adjournment thereof.

The foregoing items of business are more fully described in the Proxy Statement accompanying this Notice.

Only stockholders of record at the close of business on August 23, 2004 are entitled to notice of, and to vote at, the Annual Meeting and any adjournment or postponement thereof.

Sincerely,

A handwritten signature in black ink, appearing to read "Stuart J. Nichols".

Stuart J. Nichols
Assistant Secretary
San Jose, California

September 9, 2004

All stockholders are cordially invited to attend the Annual Meeting in person; however, to assure your representation at the Annual Meeting, you are requested to complete, sign and date the enclosed proxy card and return it in the enclosed envelope or follow the instructions on the enclosed proxy card to vote by telephone or via the Internet. Any stockholder attending the Annual Meeting may vote in person even if he or she returned a proxy card.

**2004 ANNUAL MEETING OF STOCKHOLDERS
OF
KLA-TENCOR CORPORATION**

To be held on October 18, 2004

PROXY STATEMENT

QUESTIONS AND ANSWERS REGARDING SOLICITATION AND VOTING

Why am I receiving these materials?

The Board of Directors of KLA-Tencor Corporation ("KLA-Tencor," the "Company" or "we") is providing these proxy materials for you in connection with KLA-Tencor's Annual Meeting of Stockholders to be held on Monday, October 18, 2004 at 1:00 p.m. local time. As a stockholder of record, you are invited to attend the Annual Meeting, which will be held at our offices at Three Technology Drive, Milpitas, California 95035. The purposes of the Annual Meeting are set forth in the accompanying Notice of Annual Meeting of Stockholders and this Proxy Statement.

These proxy solicitation materials and the enclosed Annual Report on Form 10-K for the fiscal year ended June 30, 2004, including financial statements, were first mailed on or about September 9, 2004 to all stockholders entitled to vote at the Annual Meeting. KLA-Tencor's principal executive offices are located at 160 Rio Robles, San Jose, California 95134, and our telephone number is (408) 875-3000.

How may I obtain KLA-Tencor's Annual Report?

A copy of our Annual Report on Form 10-K was delivered with this Proxy Statement. It is also available free of charge on the Internet from the Securities and Exchange Commission's website at www.sec.gov, as well as on our website at www.kla-tencor.com.

QUESTIONS AND ANSWERS ABOUT THE ANNUAL MEETING

Who may vote at the Annual Meeting?

You may vote if our records showed that you owned shares of KLA-Tencor Common Stock as of August 23, 2004 (the "Record Date"). At the close of business on that date, we had a total of 196,247,543 shares of Common Stock issued and outstanding, which were held of record by approximately 971 stockholders. As of the Record Date, we had no shares of Preferred Stock outstanding. You are entitled to one vote for each share that you own.

What proposals are being voted on at the Annual Meeting?

In addition to such other business as may properly come before the Annual Meeting or any adjournment thereof, the following three proposals will be presented at the Annual Meeting:

1. Electing three Class III directors to each serve for a three-year term and until their successors are duly elected;
2. Approving the Company's 2004 Equity Incentive Plan, including approval of its material terms and performance goals for purposes of Internal Revenue Code Section 162(m); and
3. Ratifying the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the fiscal year ending June 30, 2005.

How can I vote if I own shares directly?

If your shares are registered directly in your name with our transfer agent, you are considered, with respect to those shares, the stockholder of record, and these proxy materials are being sent directly to you. You may vote in accordance with the instruction described below. If you hold your shares in your own name as a holder of record, you may instruct the proxy holders how to vote your common stock in the following ways:

1. **By Telephone:** Use the toll free telephone number provided on the proxy card (specific instructions for using the telephone voting system are on the proxy card);
2. **Internet:** Use the Internet voting site listed on the proxy card (specific instructions for using the Internet voting system are on the proxy card);
3. **By Mail:** Complete, sign, date and mail the proxy card in the postage paid envelope that we have provided; or
4. **In Person:** Attend the Annual Meeting and vote your shares in person.

Whichever of these methods you select to transmit your instructions, the proxy holders will vote your shares in accordance with those instructions.

If you sign and return a proxy card without giving specific voting instructions, your shares will be voted as recommended by our Board of Directors.

How may I vote if my shares are held in a stock brokerage account, by a bank or other nominee?

If your shares are held in a stock brokerage account or by a bank or other nominee, you are considered the beneficial owner of shares held in street name, and these proxy materials are being forwarded to you by your broker or nominee who is considered, with respect to those shares, the stockholder of record. As the beneficial owner, you have the right to direct your broker on how to vote and you are also invited to attend the Annual Meeting. However, since you are not the stockholder of record, you may not vote these shares in person at the Annual Meeting. Your broker or nominee has forwarded instructions for you to use in directing the broker or nominee regarding how to vote your shares.

If a broker, bank or other nominee holds your shares, you will receive instructions from them that you must follow in order to have your shares voted.

Can I change my vote?

You may change your vote at any time prior to the vote at the Annual Meeting. To change your proxy instructions if you are a holder of record, you must:

1. Advise our Assistant Secretary in writing at our principal executive office before the proxy holders vote your shares that you wish to revoke your proxy instructions; or
2. Deliver proxy instructions dated after your earlier proxy instructions as follows:
 - (a) **By Telephone:** Use the toll free telephone number provided on the proxy card to vote again prior to 11:59 P.M. EST on October 17, 2004 (specific instructions for using the telephone voting system are on the proxy card);
 - (b) **By Internet:** Use the Internet voting site listed on the proxy card to vote again prior to 11:59 P.M. EST on October 17, 2004 (specific instructions for using the Internet voting system are on the proxy card);
 - (c) **By Mail:** Complete, sign, date and mail another proxy card bearing a later date and deliver such proxy card prior to 11:59 P.M. EST on October 17, 2004; or
 - (d) **In Person:** Attend the Annual Meeting and vote your shares in person.

How are votes counted?

The Annual Meeting will be held if a majority of the outstanding Common Stock entitled to vote is represented at the Annual Meeting. If you have returned valid proxy instructions or attend the Annual Meeting in person, your Common Stock will be counted for the purpose of determining whether there is a quorum, even if you wish to abstain from voting on some or all matters at the Annual Meeting.

Who will bear the cost of this proxy solicitation?

We will pay the cost of this proxy solicitation. KLA-Tencor has retained the services of Automatic Data Processing ("ADP") and D.F. King to aid in the solicitation of proxies from brokers, bank nominees and other institutional owners. We estimate that we will pay ADP fees of approximately \$100,000 for this solicitation activity and for forwarding solicitation material to beneficial and registered stockholders and processing the results. We estimate that we will pay D.F. King approximately \$10,000 for this solicitation activity. Certain of our directors, officers and regular employees, without additional compensation, may solicit proxies personally or by telephone.

Can my broker vote my shares if I do not instruct him or her how I would like my shares voted?

Yes, except with respect to the proposal to approve the Company's 2004 Equity Incentive Plan. If you do not give your broker voting instructions with respect to Proposal Two, approval of the 2004 Equity Incentive Plan, the broker will be prevented from voting shares held in your brokerage account (a "broker non-vote"). The New York Stock Exchange ("NYSE") has issued regulations which prohibit bankers, brokers or other nominees that are NYSE member organizations from voting in favor of proposals related to equity compensation plans unless they receive specific instructions from the beneficial owner of the shares to vote in that manner. In addition, brokers who are members of the National Association of Securities Dealers ("NASD") are also prohibited from voting on such proposals without specific instructions from beneficial holders. Thus, all shares that you hold through a broker or other nominee who is a NYSE or NASD member organization will only be voted on Proposal Two if you have provided specific voting instructions to your broker or other nominee with respect to Proposal Two.

Are abstentions and broker non-votes counted?

Shares that are voted "FOR," "AGAINST," "WITHHELD" or "ABSTAIN" are treated as being present for purposes of determining the presence of a quorum and are also treated as shares entitled to vote at the Annual Meeting ("Votes Cast").

Since abstentions will be counted for purposes of determining both (i) the presence or absence of a quorum for the transaction of business and (ii) the total number of Votes Cast with respect to a proposal (other than the election of directors), abstentions will have the same effect as a vote against the proposal (other than election of directors).

Shares that are subject to a broker non-vote are counted for purposes of determining whether a quorum exists but not for purposes of determining whether a proposal has passed. Accordingly, broker non-votes will not affect the outcome of the voting on a proposal that requires a majority of the Votes Cast.

How does the Board of Directors recommend that I vote?

The Board of Directors recommends that stockholders vote as follows:

"FOR" the election of the Class III Directors—Edward W. Barnholt, Stephen P. Kaufman and Kenneth L. Schroeder to the Board of Directors;
 "FOR" approval of the Company's 2004 Equity Incentive Plan, including approval of its material terms and performance goals for purposes of Internal Revenue Code Section 162(m); and
 "FOR" ratification of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the fiscal year ending June 30, 2005.

When proxies are properly dated, executed and returned, the shares represented by such proxies will be voted at the Annual Meeting in accordance with the instructions of the stockholder. However, if no specific instructions are given, the shares will be voted in accordance with the recommendations of our Board of Directors and as the proxy holders may determine in their discretion with respect to any other matters that properly come before the meeting.

Will any other business be transacted at the Annual Meeting?

We are not aware of any matters to be presented other than those described in this Proxy Statement. If any matters not described in the Proxy Statement are properly presented at the Annual Meeting, the proxy holders will use their own judgment to determine how to vote your shares. If the Annual Meeting is adjourned or postponed, the proxy holders can vote your shares on the new meeting date as well, unless you have revoked your proxy instructions.

Can I present other business to be transacted at the Annual Meeting?

Any stockholder may present a matter from the floor for consideration at a meeting of stockholders so long as certain procedures are followed. Under our bylaws, as amended, a stockholder notice must be delivered to, or mailed and received by, KLA-Tencor (attention: Assistant Secretary) at least 120 days prior to the annual meeting of stockholders (under the assumption that the next annual meeting of stockholders will occur on the anniversary of the same calendar day as the day of the most recent annual meeting of stockholders).

What is required in a stockholder's notice to present other business to be transacted?

The stockholder's notice must set forth, as to each proposed matter, the following:

1. A brief description of the proposed matter and reasons for conducting such business at the meeting;
2. Name and address, as they appear on KLA-Tencor's books, of the stockholder;
3. The class and number of shares of KLA-Tencor that are beneficially owned by the stockholder;
4. Any material interest of the stockholder in such business; and
5. Any other information that is required to be provided by such stockholder pursuant to Regulation 14A under the Securities Exchange Act of 1934.

Can I still present other business to be transacted if my notice is deficient?

If the stockholder notice is not in compliance with the requirements set forth in our bylaws, the presiding officer of the meeting may refuse to acknowledge the matter.

What is the deadline for stockholder proposals in connection with the 2005 Annual Meeting?

Stockholders may present proposals for action at a future meeting only if they comply with the requirements of the proxy rules established by the Securities and Exchange Commission ("SEC") and the provisions of our bylaws. We must receive stockholder proposals that are intended to be presented by such stockholders at our 2005 Annual Meeting of Stockholders no later than May 12, 2005 to be considered for inclusion in the Proxy Statement and form of Proxy relating to that meeting.

Stockholder proposals that are not intended to be included in our proxy materials for such meeting, but that are to be presented by the stockholder from the floor are subject to the advance notice provisions set forth above under "Can I present other business to be transacted at the Annual Meeting?" and other requirements set forth in our bylaws.

How may I obtain a copy of KLA-Tencor's Bylaws?

For a free copy of KLA-Tencor's bylaws, please contact our Investor Relations department at (408) 875-3600 or visit our website at www.kla-tencor.com/investors/contactinfo.html and fill out a request form.

What should I do if I receive more than one set of voting materials?

You may request delivery of a single copy of our future proxy statements and annual reports by writing to the address below or calling our Investor Relations department at the telephone number below. Stockholders may also request electronic delivery of our annual report and proxy statement by writing to the address below, calling our Investor Relations department at the telephone number below or via our website at www.icsdelivery.com/klatencor/index.html.

May I get additional copies of these materials and the exhibits to the Annual Report?

Certain stockholders who share an address are being delivered only one copy of this Proxy Statement and our 2004 Annual Report on Form 10-K. You may receive additional copies of this Proxy Statement and our Annual Report on Form 10-K for the fiscal year ended June 30, 2004 without charge or a copy of the exhibits to such Form 10-K for a reasonable fee (which shall be limited to our reasonable expenses in furnishing such exhibits) by sending a written request to KLA-Tencor Corporation, Attention: Investor Relations, 160 Rio Robles, San Jose, CA 95134. Requests may also be made by calling Investor Relations at KLA-Tencor at (408) 875-3600.

**PROPOSAL ONE:
ELECTION OF DIRECTORS**

The Company has a classified Board of Directors currently comprised of three incumbent Class I directors (Kenneth Levy, Jon D. Tompkins and Lida Urbanek), four incumbent Class II directors (H. Raymond Bingham, Robert T. Bond, Richard J. Elkus, Jr. and Michael E. Marks) and three incumbent Class III directors (Edward W. Barnholt, Stephen P. Kaufman and Kenneth L. Schroeder). The Class I directors and the Class II directors will serve until the annual meetings of stockholders to be held in 2005 and 2006, respectively, or until their respective successors are duly elected and qualified. At each annual meeting, directors are elected for a full term of three years to succeed those directors whose terms expire at the annual meeting.

Nominees

The term of the three current Class III directors will expire on the date of the Annual Meeting. Three Class III directors of the Board of Directors are to be elected at the Annual Meeting. The Nominating and Governance Committee, consisting solely of independent directors as determined under the rules of the Nasdaq National Market, recommended the nominees set forth in this Proposal One, each of whom is an incumbent director. Based on that recommendation, the members of the Board of Directors unanimously resolved to nominate such individuals for election. The nominees for election by the stockholders to these three positions are:

- Edward W. Barnholt;
- Stephen P. Kaufman; and
- Kenneth L. Schroeder.

If elected, the nominees will serve as directors until the Company's annual meeting of stockholders in 2007, or until their successors are duly elected and qualified. If any of the nominees declines to serve or becomes unavailable for any reason, or a vacancy occurs before the election, the proxies may be voted for such substitute nominees as the Board of Directors may designate. As of the date of this proxy statement, the Board is not aware of any nominee who is unable or will decline to serve as a director.

**Vote Required and
Recommendation**

If a quorum is present and voting, the three nominees for Class III directors receiving the highest number of affirmative votes will be elected as Class III directors. Votes withheld from any director and broker non-votes are counted for purposes of determining the presence or absence of a quorum but have no other legal effect on the selection of nominees for directors.

**THE MEMBERS OF THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMEND A VOTE
"FOR" EACH OF THE CLASS III NOMINEES LISTED ABOVE.**

INFORMATION ABOUT THE DIRECTORS AND THE NOMINEES

The following table sets forth certain information with respect to the Company's Board of Directors as of the date of this proxy statement:

Nominees for Election as Class III Directors

	Principal Occupation of Board Members During the Past Five Years	Age	Director Since
Edward W. Barnholt	Edward W. Barnholt has been a Director of KLA-Tencor since 1995. Since May 1999, Mr. Barnholt has been President and Chief Executive Officer of Agilent Technologies, Inc. ("Agilent") and became Chairman of the Board of Agilent in November 2002. Before being named Agilent's Chief Executive Officer, Mr. Barnholt served as Executive Vice President and General Manager of Hewlett-Packard Company's Measurement Organization from 1998 to 1999. From 1990 to 1998, he served as General Manager of Hewlett-Packard Company's Test and Measurement Organization. He was elected a Senior Vice President of Hewlett-Packard Company in 1993 and an Executive Vice President in 1996. Mr. Barnholt also serves on the boards of directors of the Tech Museum of Innovation and Silicon Valley Manufacturing Group.	61	1995
Stephen P. Kaufman	Stephen P. Kaufman has been a Director of KLA-Tencor since November 2002. He has been a Senior Lecturer at the Harvard Business School since January 2001. He was a member of the board of directors of Arrow Electronics, Inc. ("Arrow") from 1994 to May 2003. From 1986 to June 2000, he was Chief Executive Officer of Arrow. From 1985 to June 1999, he was also Arrow's President. From 1994 to June 2002, he was Chairman of the Board of Arrow. Mr. Kaufman also serves on the boards of directors of Harris Corporation and Viacore, Inc.	62	2002
Kenneth L. Schroeder	Kenneth L. Schroeder joined KLA Instruments in 1979 and left in 1987 to pursue personal and other business interests. He returned to KLA Instruments in 1991. Mr. Schroeder has been Chief Executive Officer and a member of the Board of Directors of KLA-Tencor since July 1, 1999, as well as President since May 2004. He also held the position of President from November 1991 to July 2002.	59	1991

Class II Directors

	Principal Occupation of Board Members During the Past Five Years	Age	Director Since
H. Raymond Bingham	H. Raymond Bingham has been a Director of KLA-Tencor since October 1999. He served as President and Chief Executive Officer of Cadence Design Systems, Inc. ("Cadence") from May 1999 to April 2004. Mr. Bingham has been Chairman of the Board of Cadence since May 2004 and has been a director of Cadence since November 1997. From 1993 to April 1999, Mr. Bingham served as Executive Vice President and Chief Financial Officer of Cadence. Prior to joining Cadence, Mr. Bingham was Executive Vice President and Chief Financial Officer of Red Lion Hotels, Inc. for eight years. Mr. Bingham also serves on the boards of directors of Freescale Semiconductor, Inc., Onyx Software Corporation and Oracle Corporation.	58	1999
Robert T. Bond	Robert T. Bond has been a Director of KLA-Tencor since August 2000. From April 1996 to January 1998, Mr. Bond served as Chief Operating Officer of Rational Software Corporation. Prior to that, he held various executive positions at Rational Software Corporation. Mr. Bond was employed by Hewlett-Packard Company from 1967 to 1983 and held various management positions during his tenure there. Mr. Bond also serves on the boards of directors of Portal Software, MontaVista Software, Clarus Systems and DecisionPoint Applications, Inc.	61	2000
Richard J. Elkus, Jr.	Richard J. Elkus, Jr. has been a Director of KLA-Tencor since April 1997. He was Executive Vice President and Vice Chairman of the board of directors of Tencor Instruments from February 1994 until April 1997. In addition to KLA-Tencor he currently serves on the boards of directors of Sopra SA, Lam Research Corporation, Virage Logic Corporation, the Palo Alto Medical Foundation, the National Medal of Technology Foundation, and the Board of Trustees of the Scripps Research Institute.	69	1997
Michael E. Marks	Michael E. Marks has been a Director of KLA-Tencor since November 2003. He has been the Chief Executive Officer of Flextronics International Ltd. ("Flextronics") since January 1994 and also serves on its board of directors. Mr. Marks was Chairman of the Board of Flextronics from July 1993 to January 2003. Prior to joining Flextronics, he was President and Chief Executive Officer of Metcal, Inc., a precision heating instrument company.	53	2003

Class I Directors

	Principal Occupation of Board Members During the Past Five Years	Age	Director Since
Kenneth Levy	Kenneth Levy is a founder of KLA Instruments Corporation and since July 1, 1999 has been Chairman of the Board and a Director of KLA-Tencor. From July 1998 until June 30, 1999, he was Chief Executive Officer and a Director. From 1975 until April 30, 1997 he was Chief Executive Officer of KLA Instruments Corporation. He currently serves on the boards of directors of the following publicly traded companies: Juniper Networks, Inc., Extreme Networks, Inc., and PowerDyne, Inc. In addition, he is a Director Emeritus of SEMI, an industry trade association.	61	1975
Jon D. Tompkins	Jon D. Tompkins has been a Director of KLA-Tencor since April 1997. He was Chairman of the Board from July 1998 to June 1999, when he retired from such position. From May 1997 until July 1998, he was Chief Executive Officer. From April 1991 until April 1997, Mr. Tompkins was President and Chief Executive Officer of Tencor Instruments prior to its merger with KLA Instruments Corporation. He was a director of Tencor Instruments from 1991 until April 1997 and was appointed Chairman of the Board of Directors of Tencor Instruments in November 1993. Mr. Tompkins currently serves on the boards of directors of Cymer, Inc., Electro Scientific Industries, Inc. and Credence Systems Corporation.	64	1997
Lida Urbanek	Lida Urbanek has been a Director of KLA-Tencor since April 30, 1997. She is a private investor. She was a director of Tencor Instruments from August 1991 until April 30, 1997.	61	1997

**PROPOSAL TWO:
APPROVAL OF THE COMPANY'S 2004 EQUITY INCENTIVE PLAN, INCLUDING APPROVAL
OF ITS MATERIAL TERMS AND PERFORMANCE GOALS FOR PURPOSES OF INTERNAL
REVENUE CODE SECTION 162(m)**

**Approval of the 2004
Equity Incentive Plan**

The Board of Directors is asking our stockholders to approve our 2004 Equity Incentive Plan, which will:

- Reserve 11,000,000 new shares of our Common Stock for issuance under the 2004 Equity Incentive Plan;
- Transfer up to an additional 1,500,000 shares subject to outstanding options under our 1982 Stock Option Plan and 2000 Nonstatutory Stock Option Plan if they expire or are forfeited without being exercised and terminate the 1982 Stock Option Plan (including its "evergreen" automatic replenishment feature) and 2000 Nonstatutory Stock Option Plan for any new grants; and
- Include the ability to grant restricted stock, stock appreciation rights, performance shares, performance units and deferred stock units.

The Company's stockholders are also being asked to approve the material terms of the 2004 Equity Incentive Plan and the performance goals thereunder for the purpose of helping awards under the 2004 Equity Incentive Plan qualify as "performance-based" compensation under Internal Revenue Code Section 162(m).

Any 2004 Equity Incentive Plan awards of restricted stock, performance shares, performance units or deferred stock units with a per share or unit purchase price lower than 100% of fair market value on the grant date shall be counted against the total number of shares issuable under the plan as 1.8 shares for every one share subject thereto.

As of June 30, 2004, options to purchase a total of 29,432,566 shares were

outstanding under our active stock option plans as follows:

1982 Stock Option Plan	20,343,266
2000 Nonstatutory Stock Option Plan	8,816,802
1998 Outside Director Option Plan	272,498

As of June 30, 2004, our 1982 Stock Option Plan had 12,647,812 shares remaining available for issuance and was scheduled to expire in 2006. Moreover, our 1982 Stock Option Plan has an "evergreen" automatic annual share replenishment feature whereby on the first day of each of our fiscal years, an amount of shares equal to 3% of our outstanding shares of common stock on the last day of each fiscal year plus the number of common stock shares that we repurchase on the open market for reissuance under the Plan can be added to the Plan. Pursuant to this "evergreen" annual share replenishment feature, on July 1, 2004 an additional 5,903,603 shares as of June 30, 2004 were added to the 1982 Stock Option Plan. As of June 30, 2004, our 2000 Nonstatutory Stock Option Plan had 3,098,870 shares remaining available for issuance and was scheduled to expire in 2010. If our stockholders approve this proposal, both the 1982 Stock Option Plan (including its "evergreen" feature) and the 2000 Nonstatutory Stock Option Plan shall be terminated for any new grants.

Proposed new accounting regulations are expected to require companies to record a charge to earnings for employee and director stock option grants, including options granted under plans similar to the proposed 2004 Equity Incentive Plan. The extent to which we will make grants of awards under the 2004 Equity

Incentive Plan will depend on the developments in these accounting regulations as well as several other factors, including our assessment of the impact of the final rules on our earnings, actions by other companies (particularly those with whom we compete for employees and directors) with respect to the design and operation of equity incentive plans, and the attitude of financial analysts and investors towards these potentially significant non-cash charges. The 2004 Equity Incentive Plan will allow us to grant a wider range of awards than is permitted under our current stock option plans, including restricted stock, stock appreciation rights, performance shares, performance units and deferred stock units, which will help us achieve our goal of attracting, retaining and motivating our talented personnel. We believe that the 2004 Equity Incentive Plan will be an essential element of a competitive compensation package.

Our 2004 Equity Incentive Plan has been developed to replace our 1982 Stock Option Plan and 2000 Nonstatutory Stock Option Plan and to supplement our 1998 Outside Director Option Plan. Currently, our 1982 Stock Option Plan authorizes our Board of Directors to grant stock options to our eligible employees and consultants. Our 2000 Nonstatutory Stock Option Plan authorizes our Board of Directors to grant stock options to our eligible employees and consultants who are not officers or members of the Board of Directors. Our 1998 Outside Director Option Plan provides for automatic formula option grants as well as discretionary option grants to members of our Board of Directors. Our Board of Directors approved the 2004 Equity Incentive Plan in July 2004 to replace the 1982 Stock Option Plan and 2000 Nonstatutory Stock Option Plan, subject to stockholder approval at the 2004 Annual Meeting.

As of June 30, 2004, the closing price of our common stock was \$49.38 per share. The 2004 Equity Incentive Plan provides for the grant of options to purchase shares of our Common Stock, stock appreciation rights ("SARs"), restricted stock, performance shares, performance units, and deferred stock units to our employees, consultants and members of our Board of Directors. As of June 30, 2004, there were approximately 5,200 employees (including officers) and members of our Board of Directors eligible to participate in the 2004 Equity Incentive Plan. Please see the summary of the 2004 Equity Incentive Plan below.

**Vote Required and
Recommendation**

If a quorum is present and voting, the affirmative vote of a majority of the votes cast will be required to approve the adoption of the 2004 Equity Incentive Plan. Our executive officers and members of our Board of Directors have an interest in this proposal as they may receive awards under the 2004 Equity Incentive Plan.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE "FOR" APPROVAL OF THE COMPANY'S 2004 EQUITY INCENTIVE PLAN, INCLUDING APPROVAL OF ITS MATERIAL TERMS AND PERFORMANCE GOALS FOR PURPOSES OF INTERNAL REVENUE CODE SECTION 162(M).

SUMMARY OF THE 2004 EQUITY INCENTIVE PLAN

The essential features of the 2004 Equity Incentive Plan are summarized below. This summary does not purport to be complete and is subject to, and qualified in its entirety by, the provisions of the 2004 Equity Incentive Plan, which is attached as Appendix A. Capitalized terms used herein and not defined shall have the meanings set forth in the 2004 Equity Incentive Plan.

General	The purposes of the 2004 Equity Incentive Plan are to attract and retain the best available personnel for positions of substantial responsibility, provide additional incentive to our employees and consultants, and promote the success of our business.
Administration	The 2004 Equity Incentive Plan may be administered by our Board of Directors or a committee, which our Board of Directors may appoint from among its members (the "Administrator"). Subject to the provisions of the 2004 Equity Incentive Plan, the Administrator has the authority to: (i) interpret the plan and apply its provisions; (ii) prescribe, amend or rescind rules and regulations relating to the 2004 Equity Incentive Plan; (iii) select the persons to whom awards are to be granted; (iv) subject to individual fiscal year limits applicable to each type of award, determine the number of shares or equivalent units to be made subject to each award; (v) determine whether and to what extent awards are to be granted; (vi) determine the terms and conditions applicable to awards generally and of each individual award (including the provisions of the award agreement to be entered into between the Company and the participant); (vii) amend any outstanding award subject to applicable legal restrictions (except repricing an option or SAR, unless stockholder approval is obtained); (viii) authorize any person to execute, on our behalf, any instrument required to effect the grant of an award; (ix) approve forms of agreement for use under the Plan; (x) allow participants to satisfy withholding tax obligations by electing to have the Company withhold from the shares or cash to be issued upon exercise, vesting of an award (or distribution of a deferred stock unit) that number of shares or cash having a fair market value equal to the minimum amount required to be withheld; and (xi) subject to certain limitations, take any other actions deemed necessary or advisable for the administration of the 2004 Equity Incentive Plan. All decisions, interpretations and other actions of the Administrator shall be final and binding on all holders of options or rights and on all persons deriving their rights therefrom.
Discount Award Limitations	Options and SARs may not be granted with an exercise price lower than 100% of the fair market value of the underlying shares.
Shares Counted Against the Plan	Any 2004 Equity Incentive Plan awards of restricted stock, performance shares, performance units or deferred stock units with a per share or unit purchase price lower than 100% of fair market value on the grant date shall be counted against the total number of shares issuable under the plan as 1.8 shares for every one share subject thereto.
No Repricing	The 2004 Equity Incentive Plan prohibits option or stock appreciation right repricing, including by way of an exchange for another award, unless stockholder approval is obtained.
Eligibility	The 2004 Equity Incentive Plan provides that awards may be granted to our employees, consultants and members of our Board of Directors. Incentive stock options may only be granted to employees. Any optionee who owns more than 10% of the combined voting power of all classes of outstanding stock of the Company (a "10% Stockholder") is not eligible for the grant of an incentive stock option unless the exercise price of the option is at least 110% of the fair market value of the common stock on the date of grant.

**Code Section 162(m)
Performance Goals**

We have designed the 2004 Equity Incentive Plan so that it permits us to issue awards that qualify as performance-based under Section 162(m) of the Code. Thus, the Administrator may make performance goals applicable to a participant with respect to an award. At the Administrator's discretion, one or more of the following performance goals may apply: annual revenue, cash position, earnings per share, net income, operating cash flow, operating income, return on assets, return on equity, return on sales, and total stockholder return, all as determined in accordance with accounting principles generally accepted in the United States. Except for cash position, return on equity and total stockholder return, a performance goal may apply either to the Company or to one of its business units.

**Terms and Conditions of
Options**

Each option granted under the 2004 Equity Incentive Plan is evidenced by a written stock option agreement between the optionee and us and is subject to the following terms and conditions:

- (a) *Exercise Price.* The exercise price of options may not be less than 100% of the fair market value of the common stock on the grant date the option. As our common stock is listed on the Nasdaq National Market, the fair market value is the closing sale price for the common stock (or the closing bid if no sales were reported) on the grant date.
- (b) *Form of Consideration.* The means of payment for shares issued upon exercise of an option is specified in each option agreement and generally may be made by cash, check, other shares of our common stock owned by the optionee, delivery of an exercise notice together with irrevocable instructions to a broker to deliver to us the exercise price from sale proceeds, or by a combination thereof.
- (c) *Exercise of the Option.* Each stock option agreement will specify the term of the option and the date when the option is to become exercisable. However, in no event shall an option granted under the 2004 Equity Incentive Plan be exercised more than 10 years after the date of grant. Moreover, in the case of an incentive stock option granted to a 10% stockholder, the term of the option shall be for no more than five years from the date of grant.
- (d) *Termination of Employment.* If an optionee's employment terminates for any reason (other than death or permanent disability), all options held by such optionee under the 2004 Equity Incentive Plan expire upon the earlier of (i) such period of time as is set forth in his or her option agreement or (ii) the expiration date of the option. The optionee may exercise all or part of his or her option at any time before such expiration to the extent that such option was exercisable at the time of termination of employment.
- (e) *Permanent Disability.* If an optionee is unable to continue employment with us as a result of permanent and total disability (as defined in the Code), all options held by such optionee under the 2004 Equity Incentive Plan shall expire upon the earlier of (i) 12 months after the date of termination of the optionee's employment or (ii) the expiration date of the option. The optionee may exercise all or part of his or her option at any time before such expiration to the extent that such option was exercisable at the time of termination of employment.
- (f) *Death.* If an optionee dies while employed by us, his or her options shall expire upon the earlier of (i) 12 months after the optionee's death or

(ii) the expiration date of the options. The executor or other legal representative of the optionee may exercise all or part of the optionee's option at any time before such expiration with respect to all shares subject to such option.

(g) *ISO Limitation.* If the aggregate fair market value of all shares of common stock subject to an optionee's incentive stock option that are exercisable for the first time during any calendar year exceeds \$100,000, the excess options shall be treated as nonstatutory options.

(h) *Other Provisions.* The stock option agreement may contain terms, provisions and conditions that are inconsistent with the 2004 Equity Incentive Plan as determined by the Administrator.

**Option and SAR 162(m)
Share Limit**

No participant may be granted stock options and stock appreciation rights to purchase more than 400,000 shares of common stock in any fiscal year, except that up to 1,200,000 shares may be granted in the participant's first fiscal year of service.

**Exercise Price and Other
Terms of Stock
Appreciation Rights**

The exercise price of SARs may not be less than 100% of the fair market value of the common stock on the grant date of the option. The Administrator, subject to the provisions of the 2004 Equity Incentive Plan (including the 162(m) share limit referred to above and the exercise price restrictions), shall have complete discretion to determine the terms and conditions of SARs granted under the 2004 Equity Incentive Plan.

**Payment of Stock
Appreciation Right
Amount**

Upon exercise of a SAR, the holder of the SAR shall be entitled to receive payment in an amount equal to the product of (X) the difference between the fair market value of a share on the date of exercise and the exercise price and (Y) the number of shares for which the SAR is exercised.

**Payment upon Exercise of
Stock Appreciation Right**

At the discretion of the Administrator, payment to the holder of a SAR may be in cash, shares of our common stock or a combination thereof. To the extent that a SAR is settled in cash, the shares available for issuance under the 2004 Equity Incentive Plan shall not be diminished as a result of the settlement.

**Stock Appreciation Right
Agreement**

Each SAR grant shall be evidenced by an agreement that shall specify the exercise price, the term of the SAR, the conditions of exercise, and such other terms and conditions as the committee, in its sole discretion, shall determine.

**Expiration of Stock
Appreciation Rights**

SARs granted under the 2004 Equity Incentive Plan expire as determined by the Administrator, but in no event later than ten (10) years from date of grant. No SAR may be exercised by any person after its expiration.

**Restricted Stock and
Performance Share 162(m)
Share Limit**

No participant shall be granted restricted stock or performance share awards covering, in the aggregate, more than 300,000 shares in any of our fiscal years, except that up to 750,000 shares may be granted in the participant's first fiscal year of service.

Grant of Restricted Stock

Subject to the terms and conditions of the 2004 Equity Incentive Plan, restricted stock may be granted to our employees, consultants and members of our Board of Directors at any time and from time to time at the discretion of the Administrator. Subject to the 162(m) share limit set forth above, the Administrator shall have complete discretion to determine (i) the number of shares subject to a

restricted stock award granted to any participant and (ii) the conditions for grant or for vesting that must be satisfied, which typically will be based principally or solely on continued provision of services but may include a performance-based component. Until the shares are issued, no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to the underlying shares.

Restricted Stock Award Agreement

Each restricted stock grant shall be evidenced by an agreement that shall specify the purchase price (if any) and such other terms and conditions as the Administrator shall determine; *provided, however*, that if the restricted stock grant has a purchase price, the purchase price must be paid no more than ten (10) years following the date of grant.

Grant of Performance Shares

Subject to the terms and conditions of the 2004 Equity Incentive Plan, performance shares may be granted to our employees and consultants at any time and from time to time as shall be determined at the discretion of the Administrator. Subject to the 162(m) share limit set forth above, the Administrator shall have complete discretion to determine (i) the number of shares of our common stock subject to a performance share award granted to any service provider and (ii) the conditions that must be satisfied for grant or for vesting, which typically will be based principally or solely on achievement of performance milestones but may include a service-based component.

Performance Share Award Agreement

Each performance share grant shall be evidenced by an agreement that shall specify such other terms and conditions as the Administrator, in its sole discretion, shall determine.

Grant of Performance Units

Performance units are similar to performance shares, except that they shall be settled in cash equivalent to the fair market value of the underlying shares of our common stock, determined as of the vesting date. The shares available for issuance under the 2004 Equity Incentive Plan shall not be diminished as a result of the settlement of a performance unit.

Performance Unit Award Agreement

Each performance unit grant shall be evidenced by an agreement that shall specify such terms and conditions as shall be determined at the discretion of the Administrator. However, no participant shall be granted a performance unit award covering more than one million dollars in any of our fiscal years, except that an award covering up to three million dollars may be granted in the participant's first fiscal year of service.

Deferred Stock Units

Deferred stock units shall consist of a restricted stock, performance share or performance unit award that the Administrator, in its sole discretion, permits to be paid out in installments or on a deferred basis, in accordance with rules and procedures established by the Administrator. Deferred stock units are subject to the individual annual limits that apply to each type of award.

Non-Transferability of Awards

Unless determined otherwise by the Administrator, an award granted under the 2004 Equity Incentive Plan may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the recipient, only by the recipient. If the Administrator makes an award granted under the 2004 Equity Incentive Plan transferable, such award shall contain such additional terms and conditions as the Administrator deems appropriate.

Leave of Absence	In the event that a participant goes on a leave of absence, award vesting will cease until he or she returns to work, except as required by law or as otherwise determined by the Administrator.
Part-Time Service	Unless the Administrator provides otherwise or except as otherwise required by law, any service-based vesting of awards granted under the 2004 Equity Incentive Plan shall be extended on a proportionate basis in the event an employee transitions from a full-time to a part-time work schedule, or if not on a full-time work schedule, to a schedule requiring fewer hours of service. Such vesting shall be proportionately re-adjusted prospectively in the event that the employee subsequently becomes regularly scheduled to work additional hours of service.
Adjustment Upon Changes in Capitalization	In the event that our capital stock is changed by reason of any stock split, reverse stock split, stock dividend, combination or reclassification of our common stock or any other increase or decrease in the number of issued shares of common stock effected without receipt of consideration by us, appropriate proportional adjustments shall be made in the number and class of shares of stock subject to the 2004 Equity Incentive Plan, the individual fiscal year limits applicable to restricted stock, performance share awards, SARs and options, the number and class of shares of stock subject to any award outstanding under the 2004 Equity Incentive Plan, and the exercise price of any such outstanding option or SAR or other award. Any such adjustment shall be made by the Compensation Committee of our Board of Directors, whose determination shall be conclusive.
Change of Control	In the event of a change of control, the successor corporation (or its parent or subsidiary) will assume or substitute each outstanding award. If the successor corporation refuses to assume the awards or to substitute equivalent awards, such awards shall become 100% vested. In such event, the Administrator shall notify the participant that each award subject to exercise is fully exercisable for fifteen (15) days from the date of such notice and that the award terminates upon expiration of such period.
Amendment, Suspensions and Termination of the 2004 Equity Incentive Plan	Our Board of Directors may amend, suspend or terminate the 2004 Equity Incentive Plan at any time; <i>provided, however</i> , that stockholder approval is required for any amendment to the extent necessary to comply with Rule 16b-3 promulgated under the Securities Exchange Act of 1934 ("Rule-16b-3") or Section 422 of the Code, or any similar rule or statute. If Proposal Two is approved, the 2004 Equity Incentive Plan will terminate in June 2014.

FEDERAL TAX INFORMATION

Options	<p>Options granted under the 2004 Equity Incentive Plan may be either "incentive stock options," as defined in Section 422 of the Code, or nonstatutory options.</p> <p>An optionee who is granted an incentive stock option will not recognize taxable income either at the time the option is granted or upon its exercise, although the exercise may subject the optionee to alternative minimum tax.</p> <p>Upon the sale or exchange of the shares more than two years after grant of the option and one year after exercising the option, any gain or loss will be treated as long-term capital gain or loss. If these holding periods are not satisfied, the optionee will recognize ordinary income at the time of sale or exchange equal to the difference between the exercise price and the lower of (i) the fair market value</p>
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of the shares at the date of the option exercise or (ii) the sales price of the shares. A different rule for measuring ordinary income upon such a premature disposition may apply if the optionee is also an officer, director, or 10% Stockholder. Any gain or loss recognized on such a premature disposition of the shares in excess of the amount treated as ordinary income will be characterized as long-term or short-term capital gain or loss, depending on the holding period.

All options that do not qualify as incentive stock options are referred to as nonstatutory options. An optionee will not recognize any taxable income at the time the optionee is granted a nonstatutory option. However, upon its exercise, the optionee will recognize taxable income generally measured as the excess of the then fair market value of the shares purchased over the purchase price. Any taxable income recognized in connection with an option exercise by an optionee who is also our employee will be subject to tax withholding by us. Upon resale of such shares by the optionee, any difference between the sale price and the optionee's purchase price, to the extent not recognized as taxable income as described above, will be treated as long-term or short-term capital gain or loss, depending on the holding period.

Stock Appreciation Rights

No taxable income is reportable when a stock appreciation right is granted to a participant. Upon exercise, the participant will recognize ordinary income in an amount equal to the amount of cash received and the fair market value of any shares of our common stock received less the purchase price. Any additional gain or loss recognized upon any later disposition of the shares of our common stock would be capital gain or loss.

**Restricted Stock,
Performance Units and
Performance Shares**

A participant will not have taxable income upon grant (unless, with respect to restricted stock, he or she elects to be taxed at that time). Instead, he or she will recognize ordinary income at the time of vesting equal to the fair market value (on the vesting date) of the vested shares or cash received minus any amount paid for the shares of our vested common stock.

Deferred Stock Units

A participant will generally recognize employment tax (e.g., Social Security taxes) on the vesting date of a deferred stock award equal to the value of the vested shares received minus any amount paid for the shares. A participant will generally recognize income tax upon receipt of the deferred stock award shares in an amount equal to the value of the shares minus any amount paid for the shares.

Tax Effect for Us

We generally will be entitled to a tax deduction in connection with an award under the 2004 Equity Incentive Plan in an amount equal to the ordinary income realized by a participant and at the time the participant recognizes such income (for example, the exercise of a nonqualified stock option). Special rules limit the deductibility of compensation paid to our Chief Executive Officer and to each of our four most highly compensated executive officers. Under Section 162(m) of the Code, the annual compensation paid to any of these specified executives will be deductible only to the extent that it does not exceed \$1,000,000. However, we can preserve the deductibility of certain compensation in excess of \$1,000,000 if the conditions of Section 162(m) are met with respect to awards. These conditions include stockholder approval of the 2004 Equity Incentive Plan and performance goals under the 2004 Equity Incentive Plan, setting individual annual limits on each type of award, and certain other requirements. The 2004 Equity Incentive Plan has been designed to permit the committee to grant awards that qualify as performance-based for purposes of satisfying the conditions of Section 162(m).

thereby permitting us to continue to receive a federal income tax deduction in connection with such awards.

The foregoing is only a summary of the current effect of federal income taxation upon us and upon the participant, does not purport to be complete, and does not discuss the tax consequences of the participant's death or the income tax laws of any municipality, state or foreign country in which a participant may reside.

ACCOUNTING TREATMENT

Currently, employee awards and awards to members of our Board of Directors with purchase prices at or above fair market value on the grant date typically do not result in any direct charge to our reported earnings. However, the fair market value of these awards is required to be disclosed in the notes to our financial statements. We must also disclose, in the notes to our financial statements, the pro forma impact these awards would have on our reported earnings and earnings per share if the fair value of the awards at the time of grant was treated as a compensation expense.

Currently, employee awards and awards to members of our Board of Directors with purchase prices below fair market value on the grant date result in a direct compensation expense that is typically equal to the "spread", i.e. the difference between the purchase price and the fair market value on the grant date. Typically, this expense is amortized over our earnings over the award's vesting period.

The Financial Accounting Standards Board intends to require mandatory expensing for equity awards for fiscal years commencing after December 15, 2004 (although such implementation may be delayed). In such event, we expect that all 2004 Equity Incentive Plan awards will result in direct charges to our reported earnings.

New Plan Benefits

We are unable to determine the benefits or amounts under the 2004 Equity Incentive Plan that will be received by or allocated to our executive officers named in the Summary Compensation Table, other employees or members of our Board of Directors.

**PROPOSAL THREE:
RATIFICATION OF APPOINTMENT OF PRICEWATERHOUSECOOPERS LLP AS THE
COMPANY'S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE FISCAL
YEAR ENDING JUNE 30, 2005.**

**Audit Committee
Recommendation**

The Audit Committee has the sole authority to retain or dismiss our independent auditors. The Audit Committee has selected PricewaterhouseCoopers LLP, an independent registered public accounting firm, to audit the consolidated financial statements of the Company for its 2005 fiscal year. Before making its determination, the Audit Committee carefully considered that firm's qualifications as independent auditors.

The Board of Directors, following the Audit Committee's recommendation, unanimously recommends that the stockholders vote for ratification of such appointment.

Although ratification by stockholders is not required by law, the Board of Directors has determined that it is desirable to request approval of this selection by the stockholders. If the stockholders do not ratify the appointment of PricewaterhouseCoopers LLP, the Audit Committee may reconsider its selection.

**Attendance at the Annual
Meeting**

Representatives of PricewaterhouseCoopers LLP are expected to be present at the Annual Meeting with the opportunity to make a statement if they desire to do so, and are expected to be available to respond to appropriate questions.

Fees

The aggregate fees billed by PricewaterhouseCoopers LLP, KLA-Tencor's independent auditors, in fiscal years 2004 and 2003 were as follows:

Services Rendered/Fees	2004	2003
Audit fees ⁽¹⁾	\$ 1,193,000	\$ 998,000
Audit-Related Fees ⁽²⁾	\$ 109,000	\$ 0
Total Audit and Audit-Related Fees	\$ 1,302,000	\$ 998,000
Tax Compliance	\$ 1,051,000	\$ 1,129,000
Tax Planning and Consulting	\$ 571,000	\$ 528,000
Total Tax Fees ⁽³⁾	\$ 1,622,000	\$ 1,657,000
All Other Fees ⁽⁴⁾	\$ 171,000	\$ 174,000

- (1) For professional services rendered for the audits of annual financial statements set forth in KLA-Tencor's Annual Report on Form 10-K for fiscal years 2004 and 2003, the review of quarterly financial statements included in KLA-Tencor's Form 10-Qs for fiscal years 2004 and 2003 and fees for services related to statutory and regulatory filings or engagements.
- (2) For fiscal year ended 2004, assurance and related services related to accounting consultations, audits in connection with acquisitions and preparatory work related to the Sarbanes-Oxley Act of 2002.
- (3) For fiscal years ended 2004 and 2003, tax services for U.S. foreign tax and expatriate compliance and tax planning and consulting.
- (4) For fiscal years ended 2004 and 2003, fees for services other than those described above, including, but not limited to, publications, consulting services on expatriate and other special projects.

**Pre-approval Policies
and Procedures**

The Audit Committee has adopted a policy regarding non-audit services provided by PricewaterhouseCoopers LLP, our independent auditors. First, the policy ensures the independence of our auditors by expressly naming all services that the auditors may not perform and reinforcing the principle of independence regardless of the type of service. Second, certain non-audit services such as tax-related services and acquisition advisory are permitted but limited in proportion to the audit fees paid. Third, the chair of the Audit Committee pre-approves non-audit services not specifically permitted under this policy and the Audit Committee reviews the annual plan and any subsequent engagements. Thus, all of the services described above under audit-related fees, tax fees and all other fees were approved by the Audit Committee pursuant to its pre-approval policies and procedures. On a quarterly basis, management provides written updates to the Audit Committee providing an update of audit and non-audit services, the amount of audit and non-audit service fees incurred to date, and the estimated cost to complete such services.

**Independence Assessment
by Audit Committee**

The Company's Audit Committee considered and determined that the provision of the services provided by PricewaterhouseCoopers LLP as set forth herein are compatible with maintaining PricewaterhouseCoopers LLP's independence and approved all non-audit related fees and services.

**Vote Required
Recommendation**

If a quorum is present and voting, the affirmative vote of the Votes Cast is needed to ratify the appointment of PricewaterhouseCoopers LLP as KLA-Tencor's independent registered public accounting firm, to audit the consolidated financial statements of the Company for its 2005 fiscal year.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE "FOR" THE RATIFICATION OF THE APPOINTMENT OF PRICEWATERHOUSECOOPERS LLP AS THE COMPANY'S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE FISCAL YEAR ENDING JUNE 30, 2005.

OUR CORPORATE GOVERNANCE PRACTICES

At KLA-Tencor we have always believed in strong and effective corporate governance procedures and practices. In that spirit, we have summarized several of our corporate governance practices below.

Adopting Governance Guidelines

The Board has adopted a set of corporate governance guidelines to establish a framework within which the Board will conduct its business and to guide management in its running of your Company. The governance guidelines can be found on our website at <http://ir.kla-tencor.com/disclaimer1.cfm> and are summarized below.

Monitoring Board Effectiveness

It is important that our Board and its committees are performing effectively and in the best interest of the Company and its stockholders. The Board and each committee are responsible for annually assessing their effectiveness in fulfilling their obligations. In addition, our Nominating and Governance Committee is charged with annually reviewing the Board and its membership.

Board Committee Responsibilities

The Board has three standing committees: the Audit Committee; the Compensation Committee; and the Nominating and Governance Committee. The Board has determined that each of the members of each of the committees of the Board has no material relationship with the Company (including any relationship that, in the opinion of the Board, would interfere with the exercise of independent judgment as a director) and is independent within the meaning of the Nasdaq National Market director independence standards, including in the case of the Audit Committee, the heightened "independence" standard required for such committee members.

Each Committee meets regularly and has a written charter approved by the Board, all of which were attached as appendices to the Proxy Statement related to our 2003 Annual Meeting, which was filed with the Securities and Exchange Commission on September 23, 2003 and are available via our website at www.kla-tencor.com. In addition, at each regularly scheduled Board meeting, a member of each Committee reports on any significant matters addressed by the Committee. In 2002, after reviewing the Sarbanes-Oxley Act of 2002 and the proposed rules of the SEC and the Nasdaq Stock Market, the Board revised all of its Committee charters to implement voluntarily the proposed standards and to expand the responsibilities of each Committee as well as establish independence and self-assessment requirements. The Board and each Committee regularly reviews the Committee charters.

Conducting Formal Independent Sessions

At the conclusion of each regularly scheduled Board meeting, the independent directors meet without KLA-Tencor management and the non-independent directors.

Hiring Outside Advisors

The Board and each of its Committees may retain outside advisors and consultants of their choosing at the Company's expense, without management's consent.

Avoiding Conflicts of Interest

KLA-Tencor expects its directors, executives and employees to conduct themselves with the highest degree of integrity, ethics and honesty. KLA-Tencor's credibility and reputation depend upon the good judgment, ethical standards and personal integrity of each director, executive and employee. In order to provide assurances to KLA-Tencor and its stockholders, KLA-Tencor has updated its Standards of Business Conduct to provide clear conflict of interest guidelines to its employees, as well as an explanation of reporting and investigatory procedures.

Providing Transparency	KLA-Tencor believes it is important that stockholders understand our governance practices. In order to help ensure transparency of our practices we have posted information regarding our corporate governance procedures on our website at http://ir.kla-tencor.com/disclaimer1.cfm .
Communications with the Board of Directors	Although KLA-Tencor does not have a formal policy regarding communications with the Board, stockholders may communicate with the Board by writing to the Company at KLA-Tencor Corporation, Attention: Investor Relations, 160 Rio Robles, San Jose, CA 95134. Stockholders who would like their submission directed to a member of the Board may so specify, and the communication will be forwarded, as appropriate.
Standards of Business Conduct	The Board has adopted Standards of Business Conduct for all of the Company's employees and directors, including the Company's principal executive and senior financial officers. You can obtain a copy of our Standards of Business Conduct via our website at http://ir.kla-tencor.com/disclaimer1.cfm , or by making a written request to the Company at KLA-Tencor Corporation, Attention: Investor Relations, 160 Rio Robles, San Jose, CA 95134. We will disclose any amendments to the Standards of Business Conduct or waiver of a provision therefrom, on our website at the same address.
Ensuring Auditor Independence	KLA-Tencor has taken a number of steps to ensure the continued independence of our outside auditors. Our independent auditors report directly to the Audit Committee, which also has the ability to pre-approve or reject any non-audit services proposed to be conducted by our outside auditors.
Stockholder Nominations to the Board	Please see "ABOUT THE BOARD OF DIRECTORS AND ITS COMMITTEES".

ABOUT THE BOARD OF DIRECTORS AND ITS COMMITTEES

The Board of Directors	<p>The Board of Directors of the Company held a total of five meetings during the fiscal year ended June 30, 2004. The Board of Directors has an Audit Committee, a Compensation Committee and a Nominating and Governance Committee.</p> <p>All directors other than Messrs. Levy, Schroeder and Tompkins meet the definition of independence within the meaning of the Nasdaq National Market director independence standards. None of the Company's directors fall outside of the SEC's 10% ownership safe harbor.</p> <p>During the fiscal year ended June 30, 2004, all incumbent directors attended at least 85% of the total number of meetings of the Board of Directors and each director attended 100% of the aggregate of the total number of meetings held by all committees of the Board on which each such director served (during the periods that each such director served).</p> <p>Although we do not have a formal policy regarding attendance by members of the Board at our annual meetings of stockholders, directors are encouraged to attend annual meetings of KLA-Tencor stockholders. Six directors attended the 2003 Annual Meeting of stockholders.</p>
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Audit Committee

The Audit Committee consists of Mr. Bingham, Mr. Bond, Mr. Elkus and Mr. Kaufman. During fiscal year 2004, Mr. Bingham was the chairman of the Audit Committee. The Audit Committee is responsible for appointing, compensating and overseeing the work of the Company's independent auditors, approving the services performed by the Company's independent auditors and for reviewing and evaluating the Company's accounting principles and its system of internal accounting controls. The Audit Committee held ten meetings during the last fiscal year.

Compensation Committee

The Compensation Committee consists of Mr. Barnholt, Mr. Bond, Mr. Marks and Ms. Urbanek. During fiscal year 2004, Mr. Bond was the chairman of the Compensation Committee. The Compensation Committee reviews and approves the Company's executive compensation policy and administers the Company's employee equity benefit plans. The Compensation Committee held three meetings during the last fiscal year.

**Nominating and
Governance Committee**

The Nominating and Governance Committee consists of Mr. Barnholt and Mr. Elkus. Mr. Barnholt served as the chairman of the Nominating and Governance Committee during fiscal year 2004. The Nominating and Governance Committee nominated the three Class III directors for election at the Annual Meeting. The Nominating and Governance Committee is primarily responsible for identifying and evaluating the qualifications of all candidates for election to the Board of Directors, as well as reviewing corporate governance policies and procedures. The Nominating and Governance Committee held three meetings during the last fiscal year.

It is the Nominating and Governance Committee's policy to consider candidates recommended by stockholders who have owned at least 1% of the Company's outstanding shares for at least one year and who have evidenced intent to continue as a substantial stockholder for the long term. Stockholders wishing to submit recommendations must notify the Company (attention: Assistant Secretary) of their intent to do so and provide the Company with certain information set forth in Section 11 of our bylaws and all other information regarding nominees that is required to be provided pursuant to Regulation 14A of the Securities Exchange Act of 1934, or as otherwise requested by the Nominating and Governance Committee. In addition, stockholders may nominate candidates for the Board of Directors pursuant to the provisions of Section 11 of our bylaws and in conformance with the requirements of Regulation 14A of the Securities Exchange Act of 1934.

In considering candidates for director nomination, including evaluating any recommendations from stockholders as set forth above, the Nominating and Governance Committee only considers candidates who have demonstrated executive experience, have experience in an applicable industry, or significant high level experience in accounting, legal or a technical field applicable to the Company. In addition, in evaluating director candidates, the Nominating and Governance Committee considers all factors it considers appropriate, which may include strength of character, mature judgment, career specialization, relevant technical skills, diversity and the extent to which the candidate would fill a present need on the Board.

The Nominating and Governance Committee regularly assesses the appropriate size and composition of the Board, and whether any vacancies on the Board are expected. In the event that vacancies are anticipated, or otherwise arise, the Nominating and Governance Committee considers potential candidates that may come to its attention through current members of the Board, professional search firms, stockholders who have owned at least 1% of the Company's outstanding shares for at least one year and who have evidenced intent to continue as a substantial stockholder for the long term, or other persons. In evaluating properly submitted stockholder recommendations, the Nominating and Governance Committee uses the evaluation standards discussed above and seeks to achieve a balance of knowledge, experience and capability on the Board.

DIRECTOR COMPENSATION

Employee Directors

Members of the Board of Directors who are employees do not receive any additional compensation for their services as directors.

1998 Outside Director Plan

Members of the Board who are not employees of the Company ("Outside Directors") receive benefits under the 1998 Outside Director Plan ("1998 Director Plan"), which was approved by the stockholders at the 1998 annual meeting of stockholders. Each Outside Director receives a nonstatutory stock option to purchase 10,000 shares of Common Stock as of the date on which such director first becomes an Outside Director (the "First Option"). If the new Outside Director does not join the Board at the beginning of the Company's fiscal year, the First Option will be pro rated to reflect the quarter in which such new Outside Director joins the Board. In addition, each Outside Director is automatically granted a nonstatutory stock option to purchase an additional 10,000 shares of Common Stock on the date of each subsequent annual meeting on which he or she remains an Outside Director.

The term of options granted under the 1998 Director Plan may not exceed 10 years. The 1998 Director Plan provides that the exercise price shall be equal to the fair market value of the Common Stock on the date of grant of the option. Options granted under the 1998 Director Plan become exercisable immediately upon the date of grant.

Cash Compensation

Each Outside Director receives an annual fee of \$20,000 and \$1,000 for each Board meeting they attend (\$500 if participation is by telephone), plus reasonable expenses in attending such meeting. Audit Committee members receive \$1,000 per committee meeting they attend (\$500 if participation is by telephone). The Audit Committee chair receives an annual retainer of \$10,000. Members of the Compensation Committee and the Nominating and Governance Committee receive \$500 per committee meeting they attend (\$250 if participation is by telephone).

INFORMATION ABOUT EXECUTIVE OFFICERS

Set forth below are the names, ages and positions of the executive officers of KLA-Tencor September 9, 2004.

Name and Position	Principal Occupation of the Executive Officers During the Past Five Years	Age
Kenneth Levy Chairman of the Board	Kenneth Levy is a founder of KLA Instruments Corporation and since July 1, 1999 has been Chairman of the Board and a Director of KLA-Tencor. From July 1998 until June 30, 1999, he was Chief Executive Officer and a Director. From 1975 until April 30, 1997 he was Chief Executive Officer of KLA Instruments Corporation. He currently serves on the boards of directors of the following publicly traded companies: Juniper Networks, Inc., Extreme Networks, Inc., and PowerDsine, Inc. In addition, he is a Director Emeritus of SEMI, an industry trade association.	61
Kenneth L. Schroeder President & Chief Executive Officer	Kenneth L. Schroeder joined KLA Instruments in 1979 and left in 1987 to pursue personal and other business interests. He returned to KLA Instruments in 1991. Mr. Schroeder has been Chief Executive Officer and a member of the Board of Directors of KLA-Tencor since July 1, 1999, as well as President since May 2004. He also held the position of President from November 1991 to July 2002.	59
John H. Kispert Executive Vice President & Chief Financial Officer	John H. Kispert has been Chief Financial Officer and Executive Vice President since July 2000. From July 1999 to July 2000, Mr. Kispert was Vice President of Finance and Accounting. From February 1998 to July 1999, he was Vice President of Operations for the Wafer Inspection Group. Mr. Kispert joined KLA-Tencor in February 1995 and has held a series of other management positions within the Company. He currently serves on the board of directors of North American SEMI, an industry trade association.	40
Richard P. Wallace Executive Vice President, Customer Group	Richard P. Wallace has been Executive Vice President of the Customer Group since May 2004. He was Executive Vice President of the Wafer Inspection, Review & Analysis Group since July 2000. From July 1999 to June 2000, he was the Group Vice President for Lithography and Films. From April 1998 to June 1999, he was Vice President and General Manager of the Mirage Group. From 1995 to March 1998, he was Vice President and General Manager of the Wisard division. Mr. Wallace joined KLA-Tencor in 1988 and has held a series of other management positions.	44
Dennis J. Fortino Executive Vice President, Corporate Operations	Dennis J. Fortino has been Executive Vice President of Corporate Operations since May 2004. He was Executive Vice President of the Lithography & Parametric Solutions Group from July 1999 to May 2004. From August 1997 to June 1999, he served as Vice President and General Manager of the Surfscan Division and from November 1995 to July 1997, he served as the Vice President and General Manager of the Surface Metrology Division. Mr. Fortino served as Vice President and General Manager for Spectra-Physics Lasers from July 1991 to October 1995.	58

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**Principal Stockholders**

As of August 23, 2004, based on our review of filings made with the SEC, we are aware of the following entities being the beneficial owner of more than 5% of the Company's Common Stock:

Name and Address	Number of Shares Beneficially Owned	Percent of Shares Beneficially Owned (1)
FMR Corp. ⁽²⁾⁽³⁾ 82 Devonshire Street Boston, MA 02109	21,671,609	11.04%
Capital Guardian Trust Co. ⁽²⁾ 333 South Hope Street Los Angeles, CA 90071	22,676,067	11.55%
Capital Research & Management Co. ⁽²⁾ 333 South Hope Street Los Angeles, CA 90071	12,225,000	6.23%
Wellington Management Co. LLP ⁽²⁾ 75 State Street Boston, Massachusetts 02109	10,838,451	5.52%

(1) Based on 196,247,543 outstanding shares of Common Stock as of August 23, 2004.

(2) Based on information provided pursuant to Schedule 13F filed with the Securities and Exchange Commission.

(3) FMR Corp. is a parent holding company and includes shares held by Fidelity Management Research and Fidelity International Limited.

Management

The following table sets forth the beneficial ownership of Common Stock of the Company as of August 23, 2004 by all directors, each of the named executive officers set forth in the Summary Compensation Table, and by all directors and current executive officers as a group:

Name and Address	Number of Shares Beneficially Owned	Percent of Shares Beneficially Owned (1)
Kenneth Levy ⁽²⁾	2,903,259	1.47%
Kenneth L. Schroeder ⁽³⁾	876,821	*
Edward W. Barnholt ⁽⁴⁾	85,832	*
H. Raymond Bingham ⁽⁵⁾	50,000	*
Robert T. Bond ⁽⁶⁾	52,000	*
Richard J. Elkus, Jr. ⁽⁷⁾	100,000	*
Stephen P. Kaufman ⁽⁸⁾	21,000	*
Michael E. Marks ⁽⁹⁾	10,000	*
Jon D. Tompkins ⁽¹⁰⁾	24,200	*
Lida Urbanek ⁽¹¹⁾	1,374,861	*
John H. Kispert ⁽¹²⁾	65,039	*
Richard P. Wallace ⁽¹³⁾	48,654	*
Dennis J. Fortino ⁽¹⁴⁾	105,787	*
Gary E. Dickerson ⁽¹⁵⁾	294,523	*
All directors and executive officers as a group (17 persons) ⁽¹⁶⁾	6,278,976	3.16%

* Less than 1%

- (1) Based on 196,247,543 outstanding shares of the Common Stock of the Company as of August 23, 2004.
- (2) Includes 735,122 shares subject to options which are presently exercisable or will become exercisable within 60 days of August 23, 2004, 1,769,375 shares which are held in trust for the benefit of Mr. Levy's family, 40,000 shares which are held by the Levy Family Foundation, and 358,000 shares which are held by the KGMW, L.P.
- (3) Includes 714,883 shares subject to options which are presently exercisable or will become exercisable within 60 days of August 23, 2004.
- (4) Includes 85,832 shares subject to options which are presently exercisable or will become exercisable within 60 days of August 23, 2004.
- (5) Includes 50,000 shares subject to options which are presently exercisable or will become exercisable within 60 days of August 23, 2004.
- (6) Includes 50,000 shares subject to options which are presently exercisable or will become exercisable within 60 days of August 23, 2004.
- (7) Includes 10,000 shares subject to options which are presently exercisable or will become exercisable within 60 days of August 23, 2004.
- (8) Includes 20,000 shares subject to options which are presently exercisable or will become exercisable within 60 days of August 23, 2004.
- (9) Includes 10,000 shares subject to options which are presently exercisable or will become exercisable, within 60 days of August 23, 2004.
- (10) Includes 20,000 shares subject to options which are presently exercisable or will become exercisable within 60 days of August 23, 2004.
- (11) Includes 73,892 shares subject to options which are presently exercisable or will become exercisable within 60 days of August 23, 2004, 1,271,414 shares which are held in trust for the benefit of Ms. Urbanek's family, and 29,555 shares which are held by the Urbanek Family Foundation.
- (12) Includes 58,031 shares subject to options which are presently exercisable or will become exercisable within 60 days of August 23, 2004.
- (13) Includes 45,751 shares subject to options which are presently exercisable or will become exercisable within 60 days of August 23, 2004.
- (14) Includes 99,916 shares subject to options which are presently exercisable or will become exercisable within 60 days of August 23, 2004.
- (15) Includes 287,905 shares subject to options which are presently exercisable or will become exercisable within 60 days of August 23, 2004.
- (16) Includes 2,522,764 shares subject to options which are presently exercisable or will become exercisable within 60 days of August 23, 2004.

EXECUTIVE COMPENSATION AND OTHER MATTERS**Executive Compensation**

The following table sets forth, as to the person who served as Chief Executive Officer during the fiscal year ended June 30, 2004 and each of the four other most highly compensated executive officers whose salary plus bonus exceeded \$100,000, information concerning all reportable compensation awarded to, earned by or paid to each for services to the Company in all capacities during the fiscal year ended June 30, 2004, as well as such compensation for each such individual for the Company's previous two fiscal years.

Name and Principal Position	Annual Compensation			Other Annual Compensation (\$)	Long Term Compensation (1)	
	Year	Salary	Bonus (3)		Securities Underlying Options/SARs (#)	All Other Compensation (2)
Kenneth L. Schroeder	2004	\$ 581,195	\$ 1,183,023	N/A	158,950	\$ 0
President & Chief Executive Officer	2003	\$ 577,940	\$ 199,209	N/A	94,350	\$ 9,231
	2002	\$ 492,649	\$ 218,040	N/A	341,100	\$ 1,000
John H. Kispert	2004	\$ 396,393	\$ 658,700	N/A	76,250	\$ 1,000
Executive Vice President & Chief Financial Officer	2003	\$ 324,357	\$ 167,133	N/A	37,500	\$ 5,767
	2002	\$ 238,350	\$ 166,843	N/A	60,000	\$ 1,000
Richard P. Wallace	2004	\$ 336,501	\$ 443,730	N/A	76,250	\$ 1,000
Executive Vice President, Customer Group	2003	\$ 324,674	\$ 75,545	N/A	38,500	\$ 5,766
	2002	\$ 240,096	\$ 66,328	N/A	45,000	\$ 1,000
Dennis J. Fortino	2004	\$ 332,618	\$ 489,589	N/A	76,250	\$ 1,000
Executive Vice President, Corporate Operations	2003	\$ 324,674	\$ 76,670	N/A	38,500	\$ 5,766
	2002	\$ 230,048	\$ 86,209	N/A	45,000	\$ 1,000
Gary E. Dickerson	2004	\$ 501,593	\$ 969,942	N/A	131,250	\$ 1,000
Former President & Chief Operating Officer	2003	\$ 488,451	\$ 156,657	N/A	76,000	\$ 8,104
	2002	\$ 378,269	\$ 159,046	N/A	105,000	\$ 1,000

- (1) The Company has not granted any restricted stock rights or stock appreciation rights and the Company does not have any Long Term Incentive Plans as that term is defined in the regulations.
- (2) In FY 2004 Mr. Kispert received \$1,000 contributed by the Company as a matching contribution to the 401(k) Plan; Mr. Wallace received \$1,000 contributed by the Company as a matching contribution to the 401(k) Plan; Mr. Fortino received \$1,000 contributed by the Company as a matching contribution to the 401(k) Plan; and Mr. Dickerson received \$1,000 contributed by the Company as a matching contribution to the 401(k) Plan.
- (3) In addition to other bonus payments, this amount includes payments made pursuant to the Company's Outstanding Corporate Performance Executive Bonus Plan ("OCBP"). Of the OCBP payment earned in fiscal year 2004, 34% is payable currently. The remaining 66% of the OCBP payment earned in fiscal year 2004 is automatically deferred into the Company's Executive Deferred Savings Plan ("EDSP") as a Company contribution. Executives whose employment terminates before the end of the vesting period will receive a pro rata distribution of such deferred bonus funds. The OCBP amounts for fiscal year 2004 represent 47% of the aggregate fiscal year 2004 bonus amounts for Messrs. Schroeder and Dickerson, 41% for Mr. Kispert, 51% for Mr. Wallace and 46% for Mr. Fortino.

OPTION/SAR GRANTS IN LAST FISCAL YEAR

Stock Option Grants and Exercises

The following tables set forth the number of securities underlying stock options granted to the named executive officers under the Company's stock option plans and the options exercised by such named executive officers during the fiscal year ended June 30, 2004.

The Option/SAR Grant Table sets forth hypothetical gains or "option spreads" for the options at the end of their respective ten-year terms, as calculated in accordance with the rules of the Securities and Exchange Commission. Each gain is based on an arbitrarily assumed annualized rate of compound appreciation of the market price at the date of grant of 5% and 10% from the date the option was granted to the end of the option term. Actual gains, if any, on option exercises are dependent on the future performance of the Company's Common Stock and overall market conditions.

	Number of Securities Underlying Options (1)	Percent of Total Options Granted to Employees in Fiscal Year (2)	Exercise or Base Price (\$/share)(3)	Expiration Date	Potential Realizable Value At Assumed Annual Rates of Stock Price Appreciation for Option Term (%)	
					5%	10%
Kenneth L. (4)	31,450	.50%	\$ 51.23	7/30/2013	\$ 1,012,245	\$ 2,567,761
Schroeder	60,000	.95%	\$ 53.86	10/27/2013	\$ 2,032,336	\$ 5,150,338
	30,000	.48%	\$ 58.10	1/27/2014	\$ 1,097,163	\$ 2,777,893
	37,500	.60%	\$ 45.16	4/26/2014	\$ 1,065,033	\$ 2,699,003
Total	158,950	2.53%	N/A	N/A	\$ 5,206,777	\$ 13,194,996
John H. Kispert	12,500	.20%	\$ 51.23	7/30/2013	\$ 402,721	\$ 1,020,573
	30,000	.48%	\$ 53.86	10/27/2013	\$ 1,016,168	\$ 2,575,169
	15,000	.24%	\$ 58.10	1/27/2014	\$ 548,082	\$ 1,388,947
	18,750	.30%	\$ 45.16	4/26/2014	\$ 532,517	\$ 1,349,501
Total	76,250	1.21%	N/A	N/A	\$ 2,499,487	\$ 6,334,190
Richard P. Wallace	12,500	.20%	\$ 51.23	7/30/2013	\$ 402,721	\$ 1,020,573
	30,000	.48%	\$ 53.86	10/27/2013	\$ 1,016,168	\$ 2,575,169
	15,000	.24%	\$ 58.10	1/27/2014	\$ 548,082	\$ 1,388,947
	18,750	.30%	\$ 45.16	4/26/2014	\$ 532,517	\$ 1,349,501
Total	76,250	1.21%	N/A	N/A	\$ 2,499,487	\$ 6,334,190
Dennis J. Fortino	12,500	.20%	\$ 51.23	7/30/2013	\$ 402,721	\$ 1,020,573
	30,000	.48%	\$ 53.86	10/27/2013	\$ 1,016,168	\$ 2,575,169
	15,000	.24%	\$ 58.10	1/27/2014	\$ 548,082	\$ 1,388,947
	18,750	.30%	\$ 45.16	4/26/2014	\$ 532,517	\$ 1,349,501
Total	76,250	1.21%	N/A	N/A	\$ 2,499,487	\$ 6,334,190
Gary E. Dickerson	25,000	.40%	\$ 51.23	7/30/2013	\$ 805,441	\$ 2,041,146
	50,000	.79%	\$ 53.86	10/27/2013	\$ 1,693,613	\$ 4,291,948
	25,000	.40%	\$ 58.10	1/27/2014	\$ 913,469	\$ 2,314,911
	31,250	.50%	\$ 45.16	4/26/2014	\$ 887,528	\$ 2,249,169
Total	131,250	2.08%	N/A	N/A	\$ 4,300,051	\$ 10,897,174

(1) The Company has not granted any stock appreciation rights.

(2) Based on a total of 6,298,343 options granted to employees in fiscal year 2004.

(3) Options were granted at an exercise price equal to the fair market value of the Company's Common Stock. The material terms of the grants are: (a) options granted in years 2004 and 2003, the options vest on a five year schedule with 20% vesting after one year and the remaining option shares vesting 1/48 per month for the remainder of the vesting term; (b) options granted prior to fiscal year 2002 vest on a four year schedule with 25% vesting after one year and the remaining option shares vesting 1/36 per month for the remainder of the vesting term; (c) to the extent unexercised, the options lapse after ten years; and (d) the options are non-transferable and are only exercisable during the period of employment of the optionee for 30 days following the

termination of employment, subject to limited exceptions in the cases of certain terminations, death or permanent disability of the optionee.

- (4) During FY 2004, in order to incentivize Mr. Schroeder to remain with the Company over the long-term, Mr. Schroeder received options covering 83,380 shares of Common Stock with delayed vesting. Specifically, 20% of 18,950 option shares vest 11/8/2007 with the remaining 80% to vest monthly over the following 48 months and 20% of 64,430 option shares vest 10/27/2006 with the remaining 80% to vest monthly over the following 48 months.

AGGREGATED OPTION/SAR EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUES

1982 Stock Option Plan

The following table sets forth information with respect to the persons named in the Summary Compensation Table concerning exercised and unexercised options held as of June 30, 2004.

	Number of Shares Acquired on Exercise	Value Realized	Number of Securities Underlying Unexercised Options at 6/30/2004		Value of Unexercised In-the-Money Options at 6/30/2004 (1)	
			Vested	Unvested	Exercisable	Unexercisable
Kenneth L. Schroeder	274,100	\$ 12,121,399	676,519	519,481	\$ 15,832,316	\$ 6,917,528
John H. Kispert	95,000	\$ 2,019,069	46,588	140,362	\$ 755,379	\$ 1,257,527
Richard P. Wallace	60,000	\$ 1,369,178	35,849	131,529	\$ 325,749	\$ 1,084,435
Dennis J. Fortino	83,541	\$ 1,967,462	88,931	135,195	\$ 874,852	\$ 1,149,627
Gary E. Dickerson	90,000	\$ 2,868,441	268,171	246,444	\$ 3,593,603	\$ 2,247,863

- (1) The Company has not granted any stock appreciation rights. Total value of vested options based on fair market value of Company's Common Stock of \$49.38 per share as of June 30, 2004.

EQUITY COMPENSATION PLANS

Equity Compensation Plan Information

The following table summarizes our equity compensation plans as of June 30, 2004.

	Number of securities to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under stock option plans and ESPP plans
Equity compensation plans approved by stockholders (1)	20,879,143	\$ 34.00	14,252,016
Equity compensation plans not approved by stockholders (2)	8,816,802	37.95	3,098,870
Total	29,695,945	\$ 35.11	17,350,886

- (1) In July 2004, the Company reserved an additional 5,903,603 shares of its Common Stock in accordance with the provisions of the 1982 Stock Option Plan.
- (2) On November 10, 2000 the Board approved the 2000 Nonstatutory Stock Option Plan (the "2000 Plan") and amended it on November 6, 2002. The goals for the 2000 Plan are for the issuance of nonstatutory stock options to employees and consultants of the Company or any parent or subsidiary corporation; however, officers and directors of the Company are not eligible to receive options under the 2000 Plan. Options granted under the 2000 Plan have an exercise price and a term that is determined by the plan administrator and generally vest in accordance with a schedule determined by the plan administrator at the time of grant. Upon cessation of service to the Company, the optionee will have a limited period of time, generally 90 days, in which to exercise his or her outstanding options that are vested at that time; usually this period of time is longer in the event of an optionee's death or disability. Options granted under the 2000 Plan generally are not transferable during the lifetime of an optionee; however, the plan administrator

may permit the optionee to transfer all or a portion of an option to a member of the optionee's immediate family, or to a limited liability corporation, trust or partnership for the benefit of an immediate family member. In the event that the Company is acquired by merger or asset sale, the vesting of each outstanding option under the 2000 Plan which is not to be assumed by the successor corporation will automatically accelerate in full, and all unvested shares will immediately vest and become exercisable for a period of 15 days after the optionee has been sent a notice of the acceleration. At the end of the 15-day period, unexercised options will terminate. The Board generally is authorized to amend, alter, suspend or terminate the 2000 Plan at any time, but no amendment, alteration, suspension or termination of the 2000 Plan may adversely affect any option previously granted under the plan without the written consent of the optionee. Unless sooner terminated by the Board, the 2000 Plan will terminate in 2010.

REPORT OF THE COMPENSATION COMMITTEE ON EXECUTIVE COMPENSATION

Compensation Committee

The Compensation Committee of the Board of Directors is comprised of four independent, non-employee members of the Board of Directors, none of who have interlocking relationships as defined by the Securities and Exchange Commission and all of whom meet the definition of "independent director" as currently promulgated by the Nasdaq National Market. The Compensation Committee is responsible for setting and administering the policies governing annual compensation of executive officers, considering their performance and making recommendations regarding their cash compensation and stock options to the full Board of Directors. The Compensation Committee periodically reviews its approach to executive compensation and makes changes as appropriate. The Compensation Committee may retain, and has retained in the past, consultants when necessary, as determined by the members of the Compensation Committee.

Compensation Philosophy

The compensation philosophy of the Compensation Committee is to provide a comprehensive compensation package for each executive officer that is well suited to support accomplishment of the Company's business strategies, objectives and initiatives. The Compensation Committee applies this compensation philosophy in determining appropriate executive compensation levels and other compensation factors, and the Compensation Committee reaches its decisions with a view towards the Company's overall financial performance. The goals of the Company's compensation policy are to:

- attract, retain and reward executive officers who contribute to the overall success of the Company by offering compensation that is competitive in the industry;
- motivate executive officers to achieve the Company's business objectives; and
- align the interests of executive officers with the long term interests of stockholders.

The Company currently uses a compensation package, which includes a salary, executive incentive plans and stock option grants to meet these goals.

For incentive-based compensation, the Compensation Committee considers the desirability of structuring such compensation arrangements so as to qualify for deductions available under Section 162(m) of the Internal Revenue Code, which disallows a tax deduction for any publicly-held corporation for individual compensation exceeding one million U.S. Dollars in any taxable year for any of the named executive officers, other than compensation that is "performance based". The 2004 Equity Incentive Plan, which is the subject of Proposal Two of this Proxy Statement, permits a range of equity compensation devices to qualify as performance based compensation under Section 162(m) of the Internal Revenue Code.

**Chief Executive Officer
Compensation**

For fiscal year 2004, Kenneth L. Schroeder served as Chief Executive Officer. In setting Mr. Schroeder's compensation for fiscal year 2004, the Compensation Committee considered the Company's revenue and profit in the prior fiscal year, the Company's market capitalization and data from comparable companies supplied by the Compensation Committee's compensation consultants, in addition to Mr. Schroeder's performance and continuing contributions to the Company. For fiscal year 2004, a bonus of \$1,183,023 was payable to Mr. Schroeder, based on the Company's performance as measured against a formula, which is based on meeting financial and strategic objectives as well as the Company's revenue growth objectives as compared to a peer group. This bonus formula was approved by the Compensation Committee and the independent members of the Board of Directors last fiscal year.

**Executive Officer
Compensation**

The Compensation Committee's executive compensation philosophy is based upon a belief that a substantial portion of aggregate annual compensation for executive officers should be contingent upon the Company's performance and an individual's contribution to the Company's success. In addition, the Compensation Committee strives to align the interests of the Company's executive officers with the long-term interests of stockholders through stock option grants that can result in ownership of the Company's Common Stock. The Compensation Committee endeavors to structure each executive officer's overall compensation package to be consistent with this approach and to enable the Company to attract, retain and reward personnel who contribute to the success of the Company.

In addition to stock option grants, the Company provides its executive officers with a compensation package consisting of base salary, variable incentive pay and participation in benefit plans generally available to other employees. The Committee considers market information from published survey data provided to the Committee by the Company's human resources staff. The market data consists primarily of base salary and total cash compensation rates, as well as incentive bonus and stock programs of other companies considered by the Committee to be peers in the Company's industry.

For the Company's previous fiscal year, the Committee reviewed and recommended a compensation structure, after considering a number of factors, including, the substantial economic and business challenges in the semiconductor and semiconductor capital equipment industries worldwide.

Base Salary. Salaries for executive officers are set with reference to salaries for comparable positions among other companies in the Company's industry or in industries that employ individuals of similar education and background to the executive officer based on data provided by the Compensation Committee's compensation consultants, as well as each person's job responsibilities, level of experience, individual performance and contribution to the Company's business. In making base salary decisions, the Compensation Committee exercised its discretion and judgment based upon these factors. No specific formula was applied to determine the weight of each factor.

Management Incentive Plan. Each year since fiscal 1979, the Company has adopted a management incentive plan (the "Incentive Plan") which provides for payments to officers and key employees based on the financial performance of the Company or the relevant business unit, and on the achievement of key strategic objectives which are set by senior management and approved by the Board of Directors. The Incentive Plan solely as to Messrs. Levy, Schroeder, Kispert and Dickerson is approved by the Compensation Committee and submitted to the

Board of Directors for ratification. For fiscal year 2004, the Incentive Plan set goals for profitability, achievement of measurable objectives aimed at strategic corporate goals and achievement of objectives relating to managing the ratio of assets to sales. The target goals for fiscal year 2004 were exceeded on financial objectives but underachieved on strategic objectives. As a result, approximately 107.3% of the eligible incentive plan amounts for Messrs. Levy, Schroeder, Kispert and Dickerson were paid.

Outstanding Corporate Performance Executive Bonus Plan. The Company continues to utilize its incentive plan for an additional bonus to executives in years when the Company achieves certain levels of profitability and growth (the "Outstanding Corporate Performance Plan"). The performance measurements are based on the Company's pretax margin and growth of the Company's aggregate revenues over the prior twelve months against a target group of public U.S. Companies over the same period. The target percentage for the Outstanding Corporate Performance Plan bonus is the same target percentage as utilized in determining the Incentive Plan bonus. For fiscal year 2004, bonuses were paid pursuant to the Outstanding Corporate Performance Plan at a rate of 96.3% of target.

In years that the performance goals are met, one-third of each annual amount under the Outstanding Corporate Performance Plan is payable at the end of the fiscal year; an additional one-third of each annual amount payable under the plan is payable at the end of the next fiscal year, and the final one-third of each annual amount payable under the plan is payable at the end of the next fiscal year. If the executive officer leaves during that one-year period, he receives a pro rata distribution of any deferred bonus funds.

Long-term Incentives. Long-term incentives are currently provided through the Stock Option Plan, which rewards executive officers through the growth in value of the Company's Common Stock. The Compensation Committee believes that employee equity ownership is highly motivating, provides a major incentive for employees to build stockholder value and serves to align the interests of employees with those of stockholders.

Grants of stock options to executive officers are based upon each executive officer's relative position, responsibilities, historical and expected contributions to the Company, and the executive officer's existing stock ownership and previous option grants. Stock options are granted at market price on the date of grant and will provide value to the executive officers only when the price of the Company's Common Stock increases over the exercise price. If Proposal Two is adopted, the Compensation Committee will consider granting different types of awards to executive officers under the 2004 Equity Incentive Plan.

Stock Ownership Guidelines

The Company adopted a program, approved by the Board of Directors, pursuant to which certain Company executives with the title Vice President or above and all directors are required to own a prescribed number of shares of Common Stock of the Company. These ownership requirements for eligible executives are phased in over time. Each executive submitted a five-year plan on how they plan to comply with the guidelines. As of June 30, 2004, all executives covered by these guidelines are on track to reach full compliance by 2009.

MEMBERS OF THE COMPENSATION COMMITTEE

Robert T. Bond, Chairman
 Edward W. Barnholt
 Michael E. Marks
 Lida Urbanek

**Compensation Committee
 Interlocks**

The members of the Compensation Committee are set forth in the preceding section. There are no members of the Compensation Committee who were officers or employees of the Company or any of its subsidiaries during the fiscal year, formerly officers of the Company, or had any relationship otherwise requiring disclosure hereunder.

REPORT OF THE AUDIT COMMITTEE

Audit Committee

The Company's Audit Committee is composed of four non-employee directors, each of whom meet the standards of independence and financial experience requirements of the Nasdaq National Market, as currently in effect. The Board has determined that H. Raymond Bingham is an "audit committee financial expert" within the meaning of the rules promulgated by the Securities and Exchange Commission. For fiscal year 2004, H. Raymond Bingham, Robert T. Bond, Richard J. Elkus, Jr. and Stephen P. Kaufman served as members on the Audit Committee. Mr. Bingham served as the Chairman of the Audit Committee for fiscal year 2004. The Board of Directors has adopted a written charter for the Audit Committee that details the responsibilities of the Audit Committee and was attached as Exhibit A to the Proxy Statement related to the 2003 Annual Meeting. This report relates to the activities undertaken by the Audit Committee in fulfilling such responsibilities. The charter is reviewed annually for changes, as appropriate, and is posted on the Company's website at <http://ir.kla-tencor.com/> in the Investor Presentations and Corporate Governance section.

KLA-Tencor's management is responsible for establishing and maintaining a system for internal controls and the financial reporting process. The Audit Committee is responsible for overseeing KLA-Tencor's auditing, accounting and financial reporting processes, its system of internal controls, and legal and ethical compliance. This report relates to the activities undertaken by the Audit Committee in fulfilling such responsibilities. During fiscal year 2004, the Audit Committee reviewed and discussed with the Company's management team KLA-Tencor's audited consolidated financial statements contained in KLA-Tencor's Annual Report on Form 10-K for the fiscal year ended June 30, 2004. The Audit Committee also met routinely with the independent auditors, with and without members of the KLA-Tencor management team present, to discuss their evaluation of the Company's internal controls and the overall quality of the Company's financial reporting. The Audit Committee also met with the Company's Chief Executive Officer to discuss accounting issues and risks facing the Company.

The Audit Committee also discussed with the Company's independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61, (Communication With Audit Committees).

The Audit Committee received from the independent auditors the written disclosures and the letter from the auditors required by Independence Standards Board Standard No. 1, (Independence Discussions With Audit Committees) and has discussed with the independent auditors their independence from management and KLA-Tencor. The Audit Committee also considered whether the provision of

services covered by fees paid to its independent auditors was compatible with maintaining their independence.

Based on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors, and the Board of Directors approved, the inclusion of the audited financial statements in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2004, filed with the Securities and Exchange Commission.

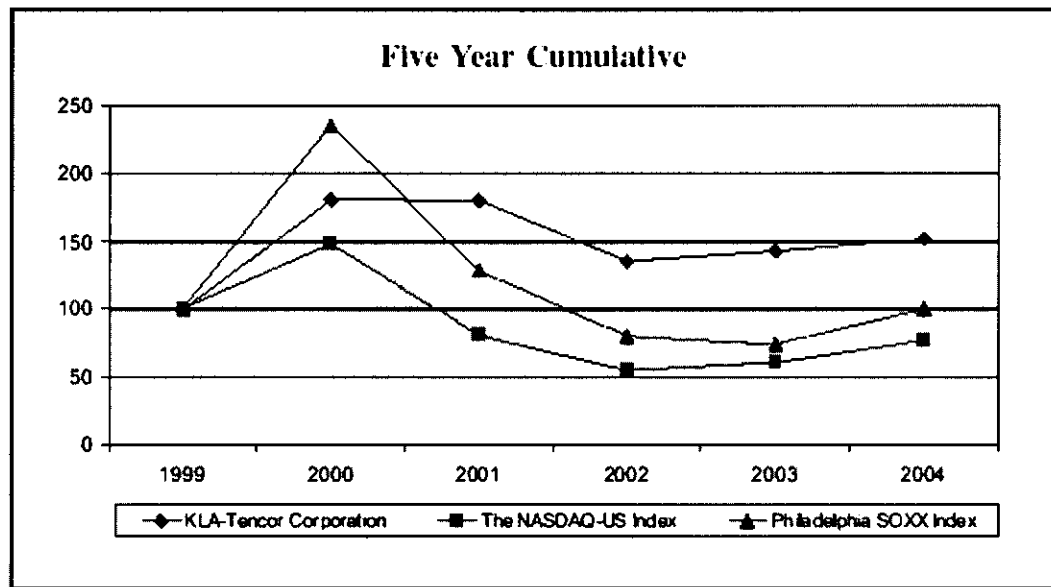
MEMBERS OF THE AUDIT COMMITTEE

H. Raymond Bingham, Chairman
Robert T. Bond
Richard J. Elkus, Jr.
Stephen P. Kaufman

PERFORMANCE GRAPH

The stock price performance shown on the following graph is not necessarily indicative of future stock price performance.

Comparison of Five Year Cumulative Total Return Among KLA-Tencor Corporation, The NASDAQ — US Index and The Philadelphia SOXX Index ⁽¹⁾



KLA-Tencor Corporation
The NASDAQ-US Index
Philadelphia SOXX Index

1999	2000	2001	2002	2003	2004
100	180.538	180.252	135.613	143.227	152.229
100	147.831	80.271	54.681	60.713	76.526
100	235.428	128.824	80.004	74.247	100.132

⁽¹⁾ Assumes \$100 invested on June 30, 1999. The Company's fiscal year end is June 30.

CERTAIN TRANSACTIONS AND OTHER MATTERS

**Transactions with
Directors, Executive
Officers and 5%
Stockholders**

In fiscal year 2001, the Company entered into a Bonus Agreement with Mr. Kispert, whereby Mr. Kispert will receive payments of \$93,900 a year, for the following four years.

**Change of Control
Agreements**

In connection with the merger between KLA Instruments Corporation and Tencor Instruments (effective April 30, 1997) the Company entered into identical employment arrangements, subsequently amended, (the "Retention and Non-Competition Agreement") with Messrs. Levy and Schroeder. The arrangements, as amended, provide that certain benefits would be paid if certain events took place after April 30, 1997. The purpose of these arrangements was to retain the services of Messrs. Levy and Schroeder to ensure the continued smooth transition associated with the merger. The terms of those arrangements provide that if an individual were to leave the Company after April 30, 1998, subject to releasing the Company from all claims, and in connection with working part-time for 36 months, he will receive (i) his base salary for the first 24 months of part-time employment, (ii) a mutually agreeable level of compensation per month for the final 12 months of part-time employment, (iii) an annual bonus (based on an achievement of 100% of bonus objectives) in the fiscal year of his transition to part-time employment, (iv) a bonus paid in the fiscal year following the payment of the annual bonus above, (based on achievement of 100% of his individual bonus objectives) and (v) a pro-rated bonus for the fiscal year in which part-time employment ended. During the periods of part-time employment, all options to exercise stock of the Company, which were granted more than 12 months prior to the termination of full-time employment, will continue to vest. The same benefits shall be payable in the event the Company terminates his employment without cause. If he is terminated for cause (defined as (i) gross negligence or willful misconduct in connection with the performance of duties, (ii) conviction of or plea of nolo contendere to any felony, or (iii) the embezzlement or misappropriation of Company property) then he will receive a lump-sum payment equal to 25% of his base salary.

In fiscal year 2002, the Board of Directors approved individual "change-in-control" agreements for Messrs. Schroeder, Dickerson and Kispert (each, an "Executive"). As of April 30, 2004, Mr. Dickerson's agreement terminated. The change-in-control provisions of these agreements take effect if the Executive's employment is terminated involuntarily or constructively within two years after a change in control of the Company. If the provisions become effective, Mr. Schroeder would receive salary and bonus under the terms of his Retention and Non-Competition Agreement and the unvested portions of his then outstanding option grants would fully accelerate. In the case of Mr. Kispert, he would become eligible to receive: (i) an amount equal to two times his annual compensation; (ii) an amount equal to two times his bonus amount; (iii) continuation of health benefits for two years; and (iv) full acceleration of vesting for all options held. For the purpose of these agreements, a change in control occurs upon merger of the Company with or into another corporation, or a change in more than half of the total voting power of the Company, or upon the sale of substantially all of the assets of the Company.

Mr. Dickerson

Mr. Dickerson, the Company's President and Chief Operating Officer resigned both positions effective as of April 30, 2004. Effective May 1, 2004 until the termination of his Severance Agreement and General Release (the "Severance Agreement"), Mr. Dickerson's job title will be "Senior Vice President, New Business Operations" and he will continue to report to the Company's Chief Executive Officer. During the term of his Severance Agreement, Mr. Dickerson will receive one-half of his base salary (effective as of April 30, 2004) plus a bonus for fiscal year 2004. Mr. Dickerson's outstanding stock options which had been granted by the Company prior to April 30, 2004, will continue to vest in accordance with the terms and conditions of the applicable original option agreements relating to such options through the earlier termination of his Agreement or March 31, 2006. In addition, during the pendency of the Severance Agreement, Mr. Dickerson will continue to receive all medical, dental, life, accident, and disability insurance and benefits that he was receiving from the Company as of April 30, 2004.

**Section 16(a) Beneficial
Ownership Reporting
Compliance**

Section 16(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") requires the Company's executive officers, directors, and persons who own more than ten percent of a registered Class of the Company's equity securities to file reports of ownership and changes in ownership with the SEC. Executive officers, directors and greater than ten percent stockholders are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file. With one exception and based solely on its review of the copies of such forms received by it, the Company believes that during fiscal year 2004 all executive officers, directors and greater than ten percent stockholders of the Company complied with all applicable filing requirements. Due to an administrative error, Ken Levy filed an amendment to a Form 4 which was filed on January 27, 2004 to update the aggregate share ownership set forth therein.

APPENDIX A

KLA-TENCOR CORPORATION
2004 EQUITY INCENTIVE PLAN1. Purposes of the Plan. The purposes of this Equity Incentive Plan are:

- to attract and retain the best available personnel for positions of substantial responsibility,
- to provide additional incentive to Service Providers, and
- to promote the success of the Company's business.

Awards granted under the Plan may be Incentive Stock Options, Nonstatutory Stock Options, Restricted Stock, Stock Appreciation Rights, Performance Shares, Performance Units or Deferred Stock Units, as determined by the Administrator at the time of grant.

2. Definitions. As used herein, the following definitions shall apply:

- (a) "Administrator" means the Board or any of its Committees that shall be administering the Plan, in accordance with Section 4 of the Plan.
- (b) "Annual Revenue" means the Company's or a business unit's net sales for the Fiscal Year, determined in accordance with generally accepted accounting principles.
- (c) "Applicable Laws" means the requirements relating to the administration of equity compensation plans under U.S. state corporate laws, U.S. federal and state securities laws, the Code, any stock exchange or quotation system on which the Shares are listed or quoted and the applicable laws of any other country or jurisdiction where Awards are granted under the Plan.
- (d) "Award" means, individually or collectively, a grant under the Plan of Options, Restricted Stock, Stock Appreciation Rights, Performance Shares, Performance Units or Deferred Stock Units.
- (e) "Award Agreement" means the written or electronic agreement setting forth the terms and provisions applicable to each Award granted under the Plan. The Award Agreement is subject to the terms and conditions of the Plan.
- (f) "Awarded Stock" means the Common Stock subject to an Award.
- (g) "Board" means the Board of Directors of the Company.
- (h) "Cash Position" means the Company's level of cash and cash equivalents.
- (i) "Change of Control" means the occurrence of any of the following events, in one or a series of related transactions:
 - (i) any "person," as such term is used in Sections 13(d) and 14(d) of the Exchange Act, other than the Company, a subsidiary of the Company or a Company employee benefit plan, including any trustee of such plan acting as trustee, is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing fifty percent (50%) or more of the combined voting power of the Company's then outstanding securities entitled to vote generally in the election of directors; or
 - (ii) a merger or consolidation of the Company or any direct or indirect subsidiary of the Company with any other corporation, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) at least fifty percent (50%) of the total voting power represented by the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation; or
 - (iii) the sale or disposition by the Company of all or substantially all the Company's assets; or

(iv) a change in the composition of the Board, as a result of which fewer than a majority of the directors are Incumbent Directors. "Incumbent Directors" shall mean directors who either (A) are Directors as of the date this Plan is approved by the Board, or (B) are elected, or nominated for election, to the Board with the affirmative votes of at least a majority of the Incumbent Directors and whose election or nomination was not in connection with any transaction described in (i) or (ii) above or in connection with an actual or threatened proxy contest relating to the election of directors of the Company.

(j) "Code" means the Internal Revenue Code of 1986, as amended.

(k) "Committee" means a Committee appointed by the Board in accordance with Section 4 of the Plan.

(l) "Common Stock" means the Common Stock of the Company.

(m) "Company" means KLA-Tencor Corporation.

(n) "Consultant" means any person, including an advisor, engaged by the Company or a Parent or Subsidiary to render services and who is compensated for such services.

(o) "Deferred Stock Unit" means a deferred stock unit Award granted to a Participant pursuant to Section 14.

(p) "Director" means a member of the Board.

(q) "Disability" means total and permanent disability as defined in Section 22(e)(3) of the Code.

(r) "Earnings Per Share" means as to any Fiscal Year, the Company's or a business unit's Net Income, divided by a weighted average number of common shares outstanding and dilutive common equivalent shares deemed outstanding, determined in accordance with generally accepted accounting principles.

(s) "Employee" means any person, including Officers and Directors, employed by the Company or any Parent or Subsidiary of the Company. A Service Provider shall not cease to be an Employee in the case of (i) any leave of absence approved by the Company or (ii) transfers between locations of the Company or between the Company, its Parent, any Subsidiary, or any successor. For purposes of Incentive Stock Options, no such leave may exceed ninety days, unless reemployment upon expiration of such leave is guaranteed by statute or contract. If reemployment upon expiration of a leave of absence approved by the Company is not so guaranteed, then three (3) months following the 91st day of such leave any Incentive Stock Option held by the Participant shall cease to be treated as an Incentive Stock Option and shall be treated for tax purposes as a Nonstatutory Stock Option.

(t) "Exchange Act" means the Securities Exchange Act of 1934, as amended.

(u) "Fair Market Value" means, as of any date, the value of Common Stock determined as follows:

(i) If the Common Stock is listed on any established stock exchange or a national market system, including without limitation the Nasdaq National Market of the National Association of Securities Dealers, Inc. Automated Quotation ("Nasdaq") System, the Fair Market Value of a Share of Common Stock shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such system or exchange (or the exchange with the greatest volume of trading in Common Stock) on the day of determination, as reported in *The Wall Street Journal* or such other source as the Administrator deems reliable;

(ii) If the Common Stock is quoted on the Nasdaq System (but not on the Nasdaq National Market thereof) or is regularly quoted by a recognized securities dealer but selling prices are not reported, the Fair Market Value of a Share of Common Stock shall be the mean between the high bid and low asked prices for the Common Stock on the last market trading day prior to the day of determination, as reported in *The Wall Street Journal* or such other source as the Administrator deems reliable; or

(iii) In the absence of an established market for the Common Stock, the Fair Market Value shall be determined in good faith by the Administrator.

(v) "Fiscal Year" means a fiscal year of the Company.

(w) "Incentive Stock Option" means an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code and the regulations promulgated thereunder.

(x) "Net Income" means as to any Fiscal Year, the income after taxes of the Company for the Fiscal Year determined in accordance with generally accepted accounting principles.

(y) "Nonstatutory Stock Option" means an Option not intended to qualify as an Incentive Stock Option.

(z) "Notice of Grant" means a written or electronic notice evidencing certain terms and conditions of an individual Award. The Notice of Grant is part of the Option Agreement.

(aa) "Officer" means a person who is an officer of the Company within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder.

(bb) "Operating Cash Flow" means the Company's or a business unit's sum of Net Income plus depreciation and amortization less capital expenditures plus changes in working capital comprised of accounts receivable, inventories, other current assets, trade accounts payable, accrued expenses, product warranty, advance payments from customers and long-term accrued expenses, determined in accordance with generally acceptable accounting principles.

(cc) "Operating Income" means the Company's or a business unit's income from operations but excluding any unusual items, determined in accordance with generally accepted accounting principles.

(dd) "Option" means a stock option granted pursuant to the Plan.

(ee) "Option Agreement" means a written or electronic agreement between the Company and a Participant evidencing the terms and conditions of an individual Option grant. The Option Agreement is subject to the terms and conditions of the Plan.

(ff) "Parent" means a "parent corporation", whether now or hereafter existing, as defined in Section 424(c) of the Code.

(gg) "Participant" means the holder of an outstanding Award granted under the Plan.

(hh) "Performance Goals" means the goal(s) (or combined goal(s)) determined by the Administrator (in its discretion) to be applicable to a Participant with respect to an Award. As determined by the Administrator, the Performance Goals applicable to an Award may provide for a targeted level or levels of achievement using one or more of the following measures: (a) Annual Revenue, (b) Cash Position, (c) Earnings Per Share, (d) Net Income, (e) Operating Cash Flow, (f) Operating Income, (g) Return on Assets, (h) Return on Equity, (i) Return on Sales, and (j) Total Stockholder Return. The Performance Goals may differ from Participant to Participant and from Award to Award.

(ii) "Performance Share" means a performance share Award granted to a Participant pursuant to Section 12.

(jj) "Performance Unit" means a performance unit Award granted to a Participant pursuant to Section 13.

(kk) "Plan" means this 2004 Equity Incentive Plan.

(ll) "Restricted Stock" means Shares granted pursuant to Section 11 of the Plan.

(mm) "Return on Assets" means the percentage equal to the Company's or a business unit's Operating Income before incentive compensation, divided by average net Company or business unit, as applicable, assets, determined in accordance with generally accepted accounting principles.

(nn) "Return on Equity" means the percentage equal to the Company's Net Income divided by average stockholder's equity, determined in accordance with generally accepted accounting principles.

(oo) "Return on Sales" means the percentage equal to the Company's or a business unit's Operating Income before incentive compensation, divided by the Company's or the business unit's, as applicable, revenue, determined in accordance with generally accepted accounting principles.

(pp) "Rule 16b-3" means Rule 16b-3 of the Exchange Act or any successor to Rule 16b-3, as in effect when discretion is being exercised with respect to the Plan.

(qq) "Section 16(b)" means Section 16(b) of the Securities Exchange Act of 1934, as amended.

(rr) "Service Provider" means an Employee, Consultant or Director.

(ss) "Share" means a share of the Common Stock, as adjusted in accordance with Section 18 of the Plan.

(tt) "Stock Appreciation Right" or "SAR" means an Award granted pursuant to Section 10 hereof.

(uu) "Subsidiary" means a "subsidiary corporation", whether now or hereafter existing, as defined in Section 424(f) of the Code.

(vv) "Total Stockholder Return" means the total return (change in share price plus reinvestment of any dividends) of a Share.

3. Stock Subject to the Plan. Subject to the provisions of Section 18 of the Plan, the maximum aggregate number of Shares which may be issued under the Plan is 11,000,000 Shares plus any shares subject to any outstanding options under the Company's 1982 Stock Option Plan and the Company's 2000 Nonstatutory Stock Option Plan that subsequently expire unexercised, up to a maximum of an additional 1,500,000 Shares.

Any Shares subject to Options or SARs shall be counted against the numerical limits of this Section 3 as one share for every share subject thereto. Any Shares or units subject to Restricted Stock, Performance Shares, Performance Units or Deferred Stock Unit Awards with a per share or unit purchase price lower than 100% of Fair Market Value on the date of grant shall be counted against the numerical limits of this Section 3 as 1.8 shares for every one share subject thereto.

The Shares may be authorized, but unissued, or reacquired Common Stock.

If an Award expires or becomes unexercisable without having been exercised in full, or, with respect to Restricted Stock, Performance Shares, Performance Units or Deferred Stock Units, is forfeited to or repurchased by the Company, the unpurchased Shares (or for Awards other than Options and SARs, the forfeited or repurchased shares) which were subject thereto shall become available for future grant or sale under the Plan (unless the Plan has terminated). With respect to SARs, only shares actually issued pursuant to an SAR shall cease to be available under the Plan; all remaining shares under SARs shall remain available for future grant or sale under the Plan (unless the Plan has terminated). However, Shares that have actually been issued under the Plan under any Award shall not be returned to the Plan and shall not become available for future distribution under the Plan; provided, however, that if Shares of Restricted Stock, Performance Shares, Performance Units or Deferred Stock Units are repurchased by the Company at their original purchase price or are forfeited to the Company, such Shares shall become available for future grant under the Plan. Shares used to pay the exercise price of an Option or Stock Purchase Right shall become available for future grant or sale under the Plan. To the extent an Award under the Plan is paid out in cash rather than stock, such cash payment shall not result in reducing the number of Shares available for issuance under the Plan.

4. Administration of the Plan.

(a) Procedure.

(i) Multiple Administrative Bodies. The Plan may be administered by different Committees with respect to different groups of Service Providers.

(ii) Section 162(m). To the extent that the Administrator determines it to be desirable to qualify Options granted hereunder as "performance-based compensation" within the meaning of Section 162(m) of the Code, the Plan shall be administered by a Committee of two or more "outside directors" within the meaning of Section 162(m) of the Code.

(iii) Rule 16b-3. To the extent desirable to qualify transactions hereunder as exempt under Rule 16b-3, the transactions contemplated hereunder shall be structured to satisfy the requirements for exemption under Rule 16b-3.

(iv) Other Administration. Other than as provided above, the Plan shall be administered by (A) the Board or (B) a Committee, which committee shall be constituted to satisfy Applicable Laws.

(b) Powers of the Administrator. Subject to the provisions of the Plan, and in the case of a Committee, subject to the specific duties delegated by the Board to such Committee, the Administrator shall have the authority, in its discretion:

- (i) to determine the Fair Market Value of the Common Stock, in accordance with Section 2(u) of the Plan;
- (ii) to select the Service Providers to whom Awards may be granted hereunder;
- (iii) to determine whether and to what extent Awards or any combination thereof, are granted hereunder;
- (iv) to determine the number of shares of Common Stock or equivalent units to be covered by each Award granted hereunder;
- (v) to approve forms of agreement for use under the Plan;
- (vi) to determine the terms and conditions, not inconsistent with the terms of the Plan, of any award granted hereunder. Such terms and conditions include, but are not limited to, the exercise price, the time or times when Options or SARs may be exercised or other Awards vest (which may be based on performance criteria), any vesting acceleration or waiver of forfeiture restrictions, and any restriction or limitation regarding any Award or the shares of Common Stock relating thereto, based in each case on such factors as the Administrator, in its sole discretion, shall determine;
- (vii) to construe and interpret the terms of the Plan and Awards;
- (viii) to prescribe, amend and rescind rules and regulations relating to the Plan, including rules and regulations relating to sub-plans established for the purpose of qualifying for preferred tax treatment under foreign tax laws;
- (ix) to modify or amend each Award (subject to Section 20(c) of the Plan), including the discretionary authority to extend the post-termination exercisability period of Options and SARs longer than is otherwise provided for in the Plan;
- (x) to authorize any person to execute on behalf of the Company any instrument required to effect the grant of an Award previously granted by the Administrator;
- (xi) to allow Participants to satisfy withholding tax obligations by electing to have the Company withhold from the Shares or cash to be issued upon exercise or vesting of an Award (or distribution of a Deferred Stock Unit) that number of Shares or cash having a Fair Market Value equal to the minimum amount required to be withheld (but no more). The Fair Market Value of any Shares to be withheld shall be determined on the date that the amount of tax to be withheld is to be determined. All elections by a Participant to have Shares or cash withheld for this purpose shall be made in such form and under such conditions as the Administrator may deem necessary or advisable;
- (xii) to determine the terms and restrictions applicable to Awards; and
- (xiii) to make all other determinations deemed necessary or advisable for administering the Plan.

(c) Effect of Administrator's Decision. The Administrator's decisions, determinations and interpretations shall be final and binding on all Participants and any other holders of Awards.

5. Eligibility. Restricted Stock, Performance Shares, Performance Units, Stock Appreciation Rights, Deferred Stock Units and Nonstatutory Stock Options may be granted to Service Providers. Incentive Stock Options may be granted only to Employees.

6. No Employment Rights. Neither the Plan nor any Award shall confer upon a Participant any right with respect to continuing the Participant's employment with the Company or its Subsidiaries, nor shall they interfere

in any way with the Participant's right or the Company's or Subsidiary's right, as the case may be, to terminate such employment at any time, with or without cause or notice.

7. Code Section 162(m) Provisions.

(a) Option and SAR Annual Share Limit. No Participant shall be granted, in any Fiscal Year, Options and Stock Appreciation Rights to purchase more than 400,000 Shares; provided, however, that such limit shall be 1,200,000 Shares in the Participant's first Fiscal Year of Company service.

(b) Restricted Stock and Performance Share Annual Limit. No Participant shall be granted, in any Fiscal Year, more than 200,000 Shares of Restricted Stock or Performance Shares; provided, however, that such limit shall be 600,000 Shares in the Participant's first Fiscal Year of Company service.

(c) Performance Units Annual Limit. No Participant shall receive Performance Units, in any Fiscal Year, having an initial value greater than \$1,000,000, provided, however, that such limit shall be \$3,000,000 in the Participant's first Fiscal Year of Company service.

(d) Section 162(m) Performance Restrictions. For purposes of qualifying grants of Restricted Stock, Performance Shares or Performance Units as "performance-based compensation" under Section 162(m) of the Code, the Administrator, in its discretion, may set restrictions based upon the achievement of Performance Goals. The Performance Goals shall be set by the Administrator on or before the latest date permissible to enable the Restricted Stock, Performance Shares or Performance Units to qualify as "performance-based compensation" under Section 162(m) of the Code. In granting Restricted Stock, Performance Shares or Performance Units which are intended to qualify under Section 162(m) of the Code, the Administrator shall follow any procedures determined by it from time to time to be necessary or appropriate to ensure qualification of the Award under Section 162(m) of the Code (e.g., in determining the Performance Goals).

(e) Changes in Capitalization. The numerical limitations in Sections 7(a) and (b) shall be adjusted proportionately in connection with any change in the Company's capitalization as described in Section 18(a).

8. Term of Plan. The Plan shall continue in effect for a term of ten (10) years following the date upon which the Board approved the Plan in 2004.

9. Stock Options.

(a) Term. The term of each Option shall be stated in the Notice of Grant; provided, however, that the term shall be ten (10) years from the date of grant or such shorter term as may be provided in the Notice of Grant. Moreover, in the case of an Incentive Stock Option granted to a Participant who, at the time the Incentive Stock Option is granted, owns stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the term of the Incentive Stock Option shall be five (5) years from the date of grant or such shorter term as may be provided in the Notice of Grant.

(b) Option Exercise Price. The per share exercise price for the Shares to be issued pursuant to exercise of an Option shall be determined by the Administrator and shall be no less than 100% of the Fair Market Value per share on the date of grant; provided, however, that in the case of an Incentive Stock Option granted to an Employee who, at the time the Incentive Stock Option is granted, owns stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the per Share exercise price shall be no less than 110% of the Fair Market Value per Share on the date of grant.

(c) No Repricing. The exercise price for an Option may not be reduced without the consent of the Company's stockholders. This shall include, without limitation, a repricing of the Option as well as an Option exchange program whereby the Participant agrees to cancel an existing Option in exchange for an Option, SAR or other Award.

(d) Waiting Period and Exercise Dates. At the time an Option is granted, the Administrator shall fix the period within which the Option may be exercised and shall determine any conditions which must be satisfied before the Option may be exercised. In so doing, the Administrator may specify that an Option may not be exercised until the completion of a service period or until performance milestones are satisfied.

(e) Form of Consideration. The Administrator shall determine the acceptable form of consideration for exercising an Option, including the method of payment. In the case of an Incentive Stock Option, the Administrator shall determine the acceptable form of consideration at the time of grant. Subject to Applicable Laws, such consideration may consist entirely of:

(i) cash;

(ii) check;

(iii) other Shares which (A) in the case of Shares acquired upon exercise of an option, have been owned by the Participant for more than six months on the date of surrender, and (B) have a Fair Market Value on the date of surrender equal to the aggregate exercise price of the Shares as to which said Option shall be exercised;

(iv) delivery of a properly executed exercise notice together with such other documentation as the Administrator and the broker, if applicable, shall require to effect an exercise of the Option and delivery to the Company of the sale proceeds required to pay the exercise price;

(v) any combination of the foregoing methods of payment; or

(vi) such other consideration and method of payment for the issuance of Shares to the extent permitted by Applicable Laws.

(f) Exercise of Option: Rights as a Stockholder. Any Option granted hereunder shall be exercisable according to the terms of the Plan and at such times and under such conditions as determined by the Administrator and set forth in the Option Agreement. An Option may not be exercised for a fraction of a Share.

An Option shall be deemed exercised when the Company receives: (i) written or electronic notice of exercise (in accordance with the Option Agreement) from the person entitled to exercise the Option, and (ii) full payment for the Shares with respect to which the Option is exercised. Full payment may consist of any consideration and method of payment authorized by the Administrator and permitted by the Option Agreement and the Plan. Shares issued upon exercise of an Option shall be issued in the name of the Participant. Until the stock certificate evidencing such Shares is issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to the optioned stock, notwithstanding the exercise of the Option. The Company shall issue (or cause to be issued) such stock certificate promptly after the Option is exercised. No adjustment will be made for a dividend or other right for which the record date is prior to the date the stock certificate is issued, except as provided in Section 18 of the Plan.

Exercising an Option in any manner shall decrease the number of Shares thereafter available for sale under the Option, by the number of Shares as to which the Option is exercised.

(g) Termination of Relationship as a Service Provider. If a Participant ceases to be a Service Provider, other than upon the Participant's death or Disability, the Participant may exercise his or her Option within such period of time as is specified in the Option Agreement to the extent that the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Option Agreement). In the absence of a specified time in the Option Agreement, the Option shall remain exercisable for three months following the Participant's termination. If, on the date of termination, the Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option shall revert to the Plan. If, after termination, the Participant does not exercise his or her Option within the time specified by the Administrator, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

(h) Disability. If a Participant ceases to be a Service Provider as a result of the Participant's Disability, the Participant may exercise his or her Option within such period of time as is specified in the Option Agreement to the extent the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Option Agreement). In the absence of a specified time in the Option Agreement, the Option shall remain exercisable for twelve (12) months following the Participant's termination. If, on the date of termination, the Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option shall revert to the Plan. If, after termination, the Participant does not exercise his or her Option within the time specified herein, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

(i) Death of Participant. If a Participant dies while a Service Provider, the Option may be exercised following the Participant's death within such period of time as is specified in the Option Agreement (but in no event may the option be exercised later than the expiration of the term of such Option as set forth in the Option Agreement), by the Participant's designated beneficiary, provided such beneficiary has been designated prior to Participant's death in a form acceptable to the Administrator. If no such beneficiary has been designated by the Participant, then such Option may be exercised by the personal representative of the Participant's estate or by the person(s) to whom the Option is transferred pursuant to the Participant's will or in accordance with the laws of descent and distribution. In the absence of a specified time in the Option Agreement, the Option shall remain exercisable for twelve (12) months following Participant's death. If the Option is not so exercised within the time specified herein, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

(j) ISO \$100,000 Rule. Each Option shall be designated in the Notice of Grant as either an Incentive Stock Option or a Nonstatutory Stock Option. However, notwithstanding such designations, to the extent that the aggregate Fair Market Value:

(i) of Shares subject to a Participant's Incentive Stock Options granted by the Company, any Parent or Subsidiary, which

(ii) become exercisable for the first time during any calendar year (under all plans of the Company or any Parent or Subsidiary) exceeds \$100,000, such excess Options shall be treated as Nonstatutory Stock Options. For purposes of this Section 9(j), Incentive Stock Options shall be taken into account in the order in which they were granted, and the Fair Market Value of the Shares shall be determined as of the time of grant.

10. Stock Appreciation Rights.

(a) Grant of SARs. Subject to the terms and conditions of the Plan, SARs may be granted to Participants at any time and from time to time as shall be determined by the Administrator, in its sole discretion. The Administrator shall have complete discretion to determine the number of SARs granted to any Participant.

(b) Exercise Price and other Terms. Subject to Section 7(a) of the Plan, the Administrator, subject to the provisions of the Plan, shall have complete discretion to determine the terms and conditions of SARs granted under the Plan; provided, however, that no SAR may have a term of more than ten (10) years from the date of grant. The exercise price for the Shares or cash to be issued pursuant to an already granted SAR may not be changed without the consent of the Company's stockholders. This shall include, without limitation, a repricing of the SAR as well as an SAR exchange program whereby the Participant agrees to cancel an existing SAR in exchange for an Option, SAR or other Award.

(c) Payment of SAR Amount. Upon exercise of a SAR, a Participant shall be entitled to receive payment from the Company in an amount determined by multiplying:

(i) The difference between the Fair Market Value of a Share on the date of exercise over the exercise price; times

(ii) the number of Shares with respect to which the SAR is exercised.

(d) Payment upon Exercise of SAR. At the discretion of the Administrator, payment for a SAR may be in cash, Shares or a combination thereof.

(e) SAR Agreement. Each SAR grant shall be evidenced by an Award Agreement that shall specify the exercise price, the term of the SAR, the conditions of exercise, and such other terms and conditions as the Administrator, in its sole discretion, shall determine.

(f) Expiration of SARs. A SAR granted under the Plan shall expire upon the date determined by the Administrator, in its sole discretion, and set forth in the Award Agreement.

(g) Termination of Relationship as a Service Provider. If a Participant ceases to be a Service Provider, other than upon the Participant's death or Disability termination, the Participant may exercise his or her SAR within such period of time as is specified in the SAR Agreement to the extent that the SAR is vested on the date of termination (but in no event later than the expiration of the term of such SAR as set forth in the SAR Agreement).

In the absence of a specified time in the SAR Agreement, the SAR shall remain exercisable for three months following the Participant's termination. If, on the date of termination, the Participant is not vested as to his or her entire SAR, the Shares covered by the unvested portion of the SAR shall revert to the Plan. If, after termination, the Participant does not exercise his or her SAR within the time specified by the Administrator, the SAR shall terminate, and the Shares covered by such SAR shall revert to the Plan.

(h) Disability. If a Participant ceases to be a Service Provider as a result of the Participant's Disability, the Participant may exercise his or her SAR within such period of time as is specified in the SAR Agreement to the extent the SAR is vested on the date of termination (but in no event later than the expiration of the term of such SAR as set forth in the SAR Agreement). In the absence of a specified time in the SAR Agreement, the SAR shall remain exercisable for twelve (12) months following the Participant's termination. If, on the date of termination, the Participant is not vested as to his or her entire SAR, the Shares covered by the unvested portion of the SAR shall revert to the Plan. If, after termination, the Participant does not exercise his or her SAR within the time specified herein, the SAR shall terminate, and the Shares covered by such SAR shall revert to the Plan.

(i) Death of Participant. If a Participant dies while a Service Provider, the SAR may be exercised following the Participant's death within such period of time as is specified in the SAR Agreement (but in no event may the SAR be exercised later than the expiration of the term of such SAR as set forth in the SAR Agreement), by the Participant's designated beneficiary, provided such beneficiary has been designated prior to Participant's death in a form acceptable to the Administrator. If no such beneficiary has been designated by the Participant, then such SAR may be exercised by the personal representative of the Participant's estate or by the person(s) to whom the SAR is transferred pursuant to the Participant's will or in accordance with the laws of descent and distribution. In the absence of a specified time in the SAR Agreement, the SAR shall remain exercisable for twelve (12) months following Participant's death. If the SAR is not so exercised within the time specified herein, the SAR shall terminate, and the Shares covered by such SAR shall revert to the Plan.

11. Restricted Stock.

(a) Grant of Restricted Stock. Subject to the terms and conditions of the Plan, Restricted Stock may be granted to Participants at any time as shall be determined by the Administrator, in its sole discretion. Subject to Section 7(b) hereof, the Administrator shall have complete discretion to determine (i) the number of Shares subject to a Restricted Stock award granted to any Participant, and (ii) the conditions that must be satisfied, which typically will be based principally or solely on continued provision of services but may include a performance-based component, upon which is conditioned the grant, vesting or issuance of Restricted Stock. Restricted Stock shall be granted in the form of units to acquire Shares. Each such unit shall be the equivalent of one Share for purposes of determining the number of Shares subject to an Award. Restricted Stock may be granted in the form of restricted stock units that are not issued until the vesting conditions are satisfied. Until the Shares are issued, no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to the units to acquire Shares.

(b) Other Terms. The Administrator, subject to the provisions of the Plan, shall have complete discretion to determine the terms and conditions of Restricted Stock granted under the Plan. Restricted Stock grants shall be subject to the terms, conditions, and restrictions determined by the Administrator at the time the stock or the restricted stock unit is awarded. The Administrator may require the recipient to sign a Restricted Stock Award agreement as a condition of the award. Any certificates representing the Shares of stock awarded shall bear such legends as shall be determined by the Administrator.

(c) Restricted Stock Award Agreement. Each Restricted Stock grant shall be evidenced by an agreement that shall specify the purchase price (if any) and such other terms and conditions as the Administrator, in its sole discretion, shall determine; provided, however, that if the Restricted Stock grant has a purchase price, such purchase price must be paid no more than ten (10) years following the date of grant.

12. Performance Shares.

(a) Grant of Performance Shares. Subject to the terms and conditions of the Plan, Performance Shares may be granted to Participants at any time as shall be determined by the Administrator, in its sole discretion. Subject to Section 7(b) hereof, the Administrator shall have complete discretion to determine (i) the number of Shares subject to a Performance Share award granted to any Participant, and (ii) the conditions that must be satisfied, which

typically will be based principally or solely on achievement of performance milestones but may include a service-based component, upon which is conditioned the grant or vesting of Performance Shares. Performance Shares shall be granted in the form of units to acquire Shares. Each such unit shall be the equivalent of one Share for purposes of determining the number of Shares subject to an Award. Until the Shares are issued, no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to the units to acquire Shares.

(b) Other Terms. The Administrator, subject to the provisions of the Plan, shall have complete discretion to determine the terms and conditions of Performance Shares granted under the Plan. Performance Share grants shall be subject to the terms, conditions, and restrictions determined by the Administrator at the time the stock is awarded, which may include such performance-based milestones as are determined appropriate by the Administrator. The Administrator may require the recipient to sign a Performance Shares agreement as a condition of the award. Any certificates representing the Shares of stock awarded shall bear such legends as shall be determined by the Administrator.

(c) Performance Share Award Agreement. Each Performance Share grant shall be evidenced by an agreement that shall specify such other terms and conditions as the Administrator, in its sole discretion, shall determine.

13. Performance Units.

(a) Grant of Performance Units. Performance Units are similar to Performance Shares, except that they shall be settled in a cash equivalent to the Fair Market Value of the underlying Shares, determined as of the vesting date. Subject to the terms and conditions of the Plan, Performance Units may be granted to Participants at any time and from time to time as shall be determined by the Administrator, in its sole discretion. The Administrator shall have complete discretion to determine the conditions that must be satisfied, which typically will be based principally or solely on achievement of performance milestones but may include a service-based component, upon which is conditioned the grant or vesting of Performance Units. Performance Units shall be granted in the form of units to acquire Shares. Each such unit shall be the cash equivalent of one Share of Common Stock. No right to vote or receive dividends or any other rights as a stockholder shall exist with respect to Performance Units or the cash payable thereunder.

(b) Number of Performance Units. Subject to Section 7(c) hereof, the Administrator will have complete discretion in determining the number of Performance Units granted to any Participant.

(c) Other Terms. The Administrator, subject to the provisions of the Plan, shall have complete discretion to determine the terms and conditions of Performance Units granted under the Plan. Performance Unit grants shall be subject to the terms, conditions, and restrictions determined by the Administrator at the time the grant is awarded, which may include such performance-based milestones as are determined appropriate by the Administrator. The Administrator may require the recipient to sign a Performance Unit agreement as a condition of the award. Any certificates representing the units awarded shall bear such legends as shall be determined by the Administrator.

(d) Performance Unit Award Agreement. Each Performance Unit grant shall be evidenced by an agreement that shall specify such terms and conditions as the Administrator, in its sole discretion, shall determine.

14. Deferred Stock Units.

(a) Description. Deferred Stock Units shall consist of a Restricted Stock, Performance Share or Performance Unit Award that the Administrator, in its sole discretion permits to be paid out in installments or on a deferred basis, in accordance with rules and procedures established by the Administrator. Deferred Stock Units shall remain subject to the claims of the Company's general creditors until distributed to the Participant.

(b) 162(m) Limits. Deferred Stock Units shall be subject to the annual 162(m) limits applicable to the underlying Restricted Stock, Performance Share or Performance Unit Award as set forth in Section 7 hereof.

15. Leaves of Absence. Unless the Administrator provides otherwise or except as otherwise required by Applicable Laws, vesting of Awards granted hereunder shall cease commencing on the first day of any unpaid leave of absence and shall only recommence upon return to active service.

16. Part-Time Service. Unless the Administrator provides otherwise or except as otherwise required by Applicable Laws, any service-based vesting of Awards granted hereunder shall be extended on a proportionate basis.

in the event an Employee transitions to a work schedule under which they are customarily scheduled to work on less than a full-time basis, or if not on a full-time work schedule, to a schedule requiring fewer hours of service. Such vesting shall be proportionately re-adjusted prospectively in the event that the Employee subsequently becomes regularly scheduled to work additional hours of service.

17. Non-Transferability of Awards. Unless determined otherwise by the Administrator, an Award may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the recipient, only by the recipient. If the Administrator makes an Award transferable, such Award shall contain such additional terms and conditions as the Administrator deems appropriate.

18. Adjustments Upon Changes in Capitalization, Dissolution or Liquidation or Change of Control.

(a) Changes in Capitalization. Subject to any required action by the stockholders of the Company, the number of shares of Common Stock covered by each outstanding Award, the number of shares of Common Stock which have been authorized for issuance under the Plan but as to which no Awards have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Award, as well as the price per share of Common Stock covered by each such outstanding Award and the 162(m) fiscal year share issuance limits under Sections 7(a) and (b) hereof shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock, or any other increase or decrease in the number of issued shares of Common Stock effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Compensation Committee, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an Award.

(b) Dissolution or Liquidation. In the event of the proposed dissolution or liquidation of the Company, the Administrator shall notify each Participant as soon as practicable prior to the effective date of such proposed transaction. The Administrator in its discretion may provide for a Participant to have the right to exercise his or her Option or SAR until ten (10) days prior to such transaction as to all of the Awarded Stock covered thereby, including Shares as to which the Award would not otherwise be exercisable. In addition, the Administrator may provide that any Company repurchase option or forfeiture rights applicable to any Award shall lapse 100%, and that any Award vesting shall accelerate 100%, provided the proposed dissolution or liquidation takes place at the time and in the manner contemplated. To the extent it has not been previously exercised (with respect to Options and SARs) or vested (with respect to other Awards), an Award will terminate immediately prior to the consummation of such proposed action.

(c) Change of Control.

(i) Stock Options and SARs. In the event of a Change of Control, each outstanding Option and SAR shall be assumed or an equivalent option or SAR substituted by the successor corporation or a Parent or Subsidiary of the successor corporation. In the event that the successor corporation refuses to assume or substitute for the Option or SAR, the Participant shall fully vest in and have the right to exercise the Option or SAR as to all of the Awarded Stock, including Shares as to which it would not otherwise be vested or exercisable. If an Option or SAR becomes fully vested and exercisable in lieu of assumption or substitution in the event of a Change of Control, the Administrator shall notify the Participant in writing or electronically that the Option or SAR shall be fully vested and exercisable for a period of fifteen (15) days from the date of such notice, and the Option or SAR shall terminate upon the expiration of such period. For the purposes of this paragraph, the Option or SAR shall be considered assumed if, following the Change of Control, the option or stock appreciation right confers the right to purchase or receive, for each Share of Awarded Stock subject to the Option or SAR immediately prior to the Change of Control, the consideration (whether stock, cash, or other securities or property) received in the Change of Control by holders of Common Stock for each Share held on the effective date of the transaction (and if holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding Shares); provided, however, that if such consideration received in the Change of Control is not solely

common stock of the successor corporation or its Parent, the Administrator may, with the consent of the successor corporation, provide for the consideration to be received upon the exercise of the Option or SAR, for each Share of Awarded Stock subject to the Option or SAR, to be solely common stock of the successor corporation or its Parent equal in fair market value to the per share consideration received by holders of Common Stock in the Change of Control.

(ii) Restricted Stock, Performance Shares, Performance Units and Deferred Stock Units. In the event of a Change of Control, each outstanding Restricted Stock, Performance Share, Performance Unit and Deferred Stock Unit award shall be assumed or an equivalent Restricted Stock, Performance Share, Performance Unit and Deferred Stock Unit award substituted by the successor corporation or a Parent or Subsidiary of the successor corporation. In the event that the successor corporation refuses to assume or substitute for the Restricted Stock, Performance Share, Performance Unit or Deferred Stock Unit award, the Participant shall fully vest in the Restricted Stock, Performance Share, Performance Unit or Deferred Stock Unit including as to Shares (or with respect to Performance Units, the cash equivalent thereof) which would not otherwise be vested. For the purposes of this paragraph, a Restricted Stock, Performance Share, Performance Unit and Deferred Stock Unit award shall be considered assumed if, following the Change of Control, the award confers the right to purchase or receive, for each Share (or with respect to Performance Units, the cash equivalent thereof) subject to the Award immediately prior to the Change of Control, the consideration (whether stock, cash, or other securities or property) received in the Change of Control by holders of Common Stock for each Share held on the effective date of the transaction (and if holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding Shares); provided, however, that if such consideration received in the Change of Control is not solely common stock of the successor corporation or its Parent, the Administrator may, with the consent of the successor corporation, provide for the consideration to be received, for each Share and each unit/right to acquire a Share subject to the Award, to be solely common stock of the successor corporation or its Parent equal in fair market value to the per share consideration received by holders of Common Stock in the Change of Control.

19. Date of Grant. The date of grant of an Award shall be, for all purposes, the date on which the Administrator makes the determination granting such Award, or such other later date as is determined by the Administrator. Notice of the determination shall be provided to each Participant within a reasonable time after the date of such grant.

20. Amendment and Termination of the Plan.

(a) Amendment and Termination. The Board may at any time amend, alter, suspend or terminate the Plan; provided, however, that the Board may not materially amend the Stock Plan without obtaining stockholder approval.

(b) Stockholder Approval. The Company shall obtain stockholder approval of any Plan amendment to the extent necessary and desirable to comply Section 422 of the Code (or any successor rule or statute or other applicable law, rule or regulation, including the requirements of any exchange or quotation system on which the Common Stock is listed or quoted). Such stockholder approval, if required, shall be obtained in such a manner and to such a degree as is required by the applicable law, rule or regulation.

(c) Effect of Amendment or Termination. No amendment, alteration, suspension or termination of the Plan shall impair the rights of any Participant, unless mutually agreed otherwise between the Participant and the Administrator, which agreement must be in writing (or electronic format) and signed by the Participant and the Company.

21. Conditions Upon Issuance of Shares.

(a) Legal Compliance. Shares shall not be issued pursuant to the exercise of an Award unless the exercise of the Award or the issuance and delivery of such Shares (or with respect to Performance Units, the cash equivalent thereof) shall comply with Applicable Laws and shall be further subject to the approval of counsel for the Company with respect to such compliance.

(b) Investment Representations. As a condition to the exercise or receipt of an Award, the Company may require the person exercising or receiving such Award to represent and warrant at the time of any such exercise or receipt that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required.

22. Liability of Company.

(a) Inability to Obtain Authority. The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

(b) Grants Exceeding Allotted Shares. If the Awarded Stock covered by an Award exceeds, as of the date of grant, the number of Shares which may be issued under the Plan without additional stockholder approval, such Award shall be void with respect to such excess Awarded Stock, unless stockholder approval of an amendment sufficiently increasing the number of Shares subject to the Plan is timely obtained in accordance with Section 20(b) of the Plan.

23. Reservation of Shares. The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.



KLA-TENCOR CORPORATION
C/O EQUISERVE
150 ROYALL STREET
CANTON, MA 02021
MS 45-02-62

VOTE BY INTERNET – www.proxyvote.com

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time on October 17, 2004. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

VOTE BY PHONE – 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time on October 17, 2004. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL

Mark, sign, and date your proxy card and return it in the postage-paid envelope we have provided or return it to KLA-Tencor Corporation, c/o ADP, 51 Mercedes Way, Edgewood, NY 11717.

Your telephone or Internet vote authorizes the named proxies to vote your shares in the same manner as if you marked, signed and returned your proxy card.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:

KLATN1

KEEP THIS PORTION FOR YOUR RECORDS

DETACH AND RETURN THIS PORTION ONLY

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

KLA-TENCOR CORPORATION (the "Company")

The Board Recommends a Vote "FOR" all Nominees for Director, "FOR" Proposal 2 and "FOR" Proposal 3.

Vote On Directors

1. To elect three Class III directors to each serve for a three year term and until their successors are duly elected.

- a. Edward W. Barnholt
 b. Stephen P. Kaufman
 c. Kenneth L. Schroeder

For All	Withhold All	For All Except
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

To withhold authority to vote, mark "For All Except" and clearly write the nominee's letter on the line below.

Vote on Proposals

2. To approve the Company's 2004 Equity Incentive Plan, including approval of its material terms and performance goals for purposes of Internal Revenue Code Section 162(m).
3. To ratify the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the fiscal year ending June 30, 2005.

For	Against	Abstain
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

To transact such other business as may properly come before the meeting or any adjournment thereof.

In their discretion, the proxy holders are authorized to vote on all such other matters as may properly come before the meeting or any adjournment or postponement thereof.

Please sign exactly as your name appears on your stock certificate(s), date and return this Proxy promptly in the postage-paid envelope provided or vote by Internet or by telephone. Please correct your address before returning this Proxy. Persons signing in a fiduciary capacity should so indicate. If shares are held by joint tenants or as community property, both should sign.

HOUSEHOLDING ELECTION – Please indicate if you consent to receive certain future investor communications in a single package per household

Yes	No
<input type="checkbox"/>	<input type="checkbox"/>

Signature [PLEASE SIGN WITHIN BOX]

Date

Signature (Joint Owners)

Date

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

KLA-TENCOR CORPORATION
Notice of Annual Meeting of Stockholders
October 18, 2004

To the Stockholders:

NOTICE IS HEREBY GIVEN that the Annual Meeting of Stockholders of KLA-Tencor Corporation (the "Company"), a Delaware corporation, will be held on Monday, October 18, 2004 at 1:00 P.M., local time, at the Company's offices located at Three Technology Drive, Milpitas, California 95035, for the purposes stated on the reverse side.

The undersigned hereby appoints John H. Kispert and Stuart J. Nichols, or either of them, as proxies, each with the power to appoint his substitute, and hereby authorizes them to represent and to vote, as designated on the reverse side, all of the shares of Common Stock of KLA-Tencor Corporation that the undersigned is entitled to vote at the Annual Meeting of Stockholders, and any adjournment or postponement thereof.

THIS PROXY, WHEN PROPERLY EXECUTED, WILL BE VOTED AS DIRECTED BY THE UNDERSIGNED STOCKHOLDER. IF NO SUCH DIRECTIONS ARE MADE, THIS PROXY WILL BE VOTED FOR THE ELECTION OF THE NOMINEES LISTED ON THE REVERSE SIDE FOR THE BOARD OF DIRECTORS AND FOR PROPOSALS 2 AND 3.

PLEASE MARK, SIGN, DATE AND RETURN THIS PROXY CARD PROMPTLY USING THE ENCLOSED POSTAGE-PAID ENVELOPE.

**SEE REVERSE
SIDE**

CONTINUED AND TO BE SIGNED ON REVERSE SIDE

**SEE REVERSE
SIDE**